



Office of Inspector General

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Report No. EVAL-09-006

**The FDIC's Role in the Monitoring of
IndyMac Bank**

Office of Evaluations





Background and Purpose of Evaluation

The Office of Thrift Supervision (OTS) closed IndyMac Federal Savings Bank (IMB) on July 11, 2008. As of July 31, 2009, the estimated cost of the resolution to the Deposit Insurance Fund is approximately \$10.7 billion.

The OTS was the primary federal regulator (PFR) for IMB and was statutorily responsible for conducting full-scope on-site examinations of IMB to assess safety and soundness, and compliance with consumer protection laws and regulations.

The FDIC has the unique role of insuring deposits in the nation's financial institutions. In this capacity, the FDIC is responsible for regularly monitoring and assessing potential risks to the Deposit Insurance Fund. The Division of Supervision and Consumer Protection (DSC) monitors non-FDIC supervised institutions, such as IMB, through its Case Manager Program and a number of monitoring systems. Additionally, the FDIC, by statute, has special examination authority and certain enforcement authority for all insured depository institutions for which it is not the PFR.

The objective of our review was to evaluate the FDIC's role in monitoring IMB, including determining: (1) when the FDIC became aware of problems at IMB and (2) what actions were taken by the FDIC to mitigate those problems.

To view the full report, go to www.fdicig.gov/2009reports.asp

The FDIC's Role in the Monitoring of IndyMac Bank

Results of Evaluation

In its role as insurer, the FDIC identified and monitored risks that IMB presented to the Deposit Insurance Fund by participating with the OTS in on-site examinations of IMB in 2001, 2002, 2003, and again shortly before IMB failed in 2008 and through the completion of required reports and analysis of IMB based upon information from FDIC monitoring systems. FDIC risk committees also raised broad concerns about the impact that an economic slowdown could have on institutions like IMB that were heavily involved in securitizations and subprime lending. Nevertheless, FDIC officials consistently concluded that despite its high-risk profile, IMB posed an ordinary or slightly more than ordinary level of risk to the insurance fund. It was not until August 2007 that the FDIC began to understand the implications that the historic collapse of the credit market and housing slowdown could have on IMB and took additional actions to evaluate IMB's viability.

Our evaluation presents the FDIC's monitoring efforts of IMB in three periods:

- Phase 1: 2001-2003: During this time, the FDIC was actively engaged in monitoring IMB and participated with OTS in on-site examinations.
- Phase 2: 2004 through Mid-2007: The FDIC discontinued participating in on-site examinations and relied on OTS examinations and off-site monitoring tools and systems to monitor IMB. The FDIC also experienced turnover in the case manager position responsible for monitoring IMB.
- Phase 3: Mid-2007 through Mid-2008: In response to problems at Countrywide, the FDIC reassessed IMB and other financial institutions with similar business models, exercised back-up examination authority, and downgraded its Large Insured Depository Institution (LIDI) rating of IMB. The FDIC raised IMB's insurance premium assessment beginning in 2008 but did not take, or suggest that OTS take, any enforcement action against IMB. The FDIC cited OTS' consistently favorable composite ratings and the protracted process for taking such action as substantial obstacles.

Because the FDIC has taken and is considering actions to address lessons learned from recent events in the banking industry and because our evaluation focused on one institution, we did not make recommendations to the Corporation. Instead we identified four matters for further study and consideration related to:

- The FDIC's frameworks for establishing a supervisory approach and making deposit insurance determinations.
- Delegations of authority and reporting requirements surrounding back-up examination authority decisions.
- Appointment and transition of case managers for large, high-risk institutions.
- Authorities related to requesting back-up examinations and pursuing enforcement actions against non-supervised institutions.

Management Response

DSC provided a written response to a draft of this report. DSC's response addressed steps underway to track all back-up examinations and to address case manager appointment and transition.

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ACRONYMS IN THE REPORT

CAMELS	<u>C</u> apital, <u>A</u> sset quality, <u>M</u> anagement capability, quality and level of <u>E</u> arnings, adequacy of <u>L</u> iquidity, and <u>S</u> ensitivity to market risk.
DIR	Division of Insurance and Research
DRR	Division of Resolutions and Receiverships
DSC	Division of Supervision and Consumer Protection
E&Y	Ernst & Young
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
ORL	Offsite Review List
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FHLB	Federal Home Loan Bank
FRB	Federal Reserve Board of Governors
FSB	Federal Savings Bank
IMB	IndyMac Bank, Federal Savings Bank
LIDI	Large Insured Depository Institution
PCA	Prompt Corrective Action
PFR	primary federal regulator
QLA	Quarterly Lending Alert
RAC	Risk Analysis Center
REIT	Real Estate Investment Trust
RRPS	Risk Related Premium System
SAER	Summary Analysis of Examination Report
SFRO	FDIC San Francisco Regional Office
TFR	Thrift Financial Report
ViSION	Virtual Supervisory Information on the Net



DATE: August 27, 2009

MEMORANDUM TO: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

FROM: [Signed]
E. Marshall Gentry
Acting Assistant Inspector General for Evaluations

SUBJECT: *The FDIC's Role in the Monitoring of IndyMac Bank*
(Report No. EVAL-09-006)

This report presents the results of our evaluation of the FDIC's role in monitoring IndyMac Bank, FSB, Pasadena, California (IMB), performed at the request of the FDIC Chairman. The Office of Thrift Supervision (OTS) closed IMB on July 11, 2008, and the FDIC was named conservator. The FDIC transferred insured deposits and substantially all of IMB's assets to IndyMac Federal Bank, FSB. IMB had total assets of \$32.01 billion and total deposits of \$19.06 billion as of March 31, 2008. As of July 31, 2009, the estimated cost of the resolution to the Deposit Insurance Fund is approximately \$10.7 billion.

EVALUATION OBJECTIVE AND APPROACH

Our objective was to evaluate the FDIC's role in monitoring IMB, including determining: (1) when the FDIC became aware of problems at IMB and (2) what actions were taken by the FDIC to mitigate those problems. To accomplish our objective, we:

- Gained an understanding of the respective responsibilities and authority of the OTS, as the primary federal regulator (PFR) for IMB, and the FDIC, in its capacity as insurer of deposits at banks and savings associations, to understand the FDIC's overall risk monitoring framework and related activities.
- Reviewed the FDIC's role in monitoring IMB for the 8-year period that IMB was in existence (2000-2008).

For reporting purposes, our discussion of the FDIC's risk monitoring activities for IMB is captured under three distinct timeframes. Within each phase, we assessed the FDIC's risk monitoring activities from two perspectives—broad and IMB-specific.

We performed our evaluation from October 2008 through April 2009 in accordance with the *Quality Standards for Inspections*. Details on our objective, scope, and methodology are provided in Appendix I. Appendix II contains a glossary of terms used in this report.

BACKGROUND

HISTORY OF IMB FSB

IMB was formed on July 1, 2000 as a result of a merger between SGV Bancorp, the holding company for First Federal Savings and Loan of San Gabriel Valley, Covina, CA, and IndyMac Bancorp. IndyMac Bancorp contributed substantially all of its assets, liabilities, and operations to IMB, raising IMB's total assets to nearly \$5 billion overnight. Included in the contribution of assets were mortgage backed securities, mortgage servicing rights, and loans held for sale. Table 1 summarizes IMB's business profile throughout its existence.

Table 1: IMB's Business Profile

Pursued an Aggressive Growth Posture	<ul style="list-style-type: none">– IMB pursued an aggressive growth posture from its inception as an insured financial institution. Rapid growth in lending was facilitated by increasingly lax underwriting within a very competitive market, primarily southern California.– IMB grew to become the seventh largest savings association and ninth largest servicer of mortgages in the United States.
Focused on an Originate-to-Sell Platform	<ul style="list-style-type: none">– Originated residential loans for the purposes of sale, securitization, and its own portfolio. Because IMB's business market model was an "originate-to-sell" platform, its aggressive posture is reflected more in its originations than asset growth.– During 2006, the bank originated \$91.7 billion in loans. In the first half of 2007, the bank originated \$46 billion in loans.
Relied on Alternative A Paper (Alt-A) Loan Production for Growth	<ul style="list-style-type: none">– The bank's Alt-A loans (a type of mortgage between prime and subprime) were generally jumbo loans that were underwritten largely based on the borrower's credit score and the loan-to-value ratio. Many of these loans did not have a full verification of income or assets. These are referred to as "no doc" or "low doc" loans.
Created High-Risk Asset Concentrations	<ul style="list-style-type: none">– Concentrations included non-traditional mortgages with negative amortization potential, Alt-A mortgage loans, and geographic concentration of loans in California that were rated high- or very high-risk by several mortgage companies.
Relied on Non-Core Funding	<ul style="list-style-type: none">– To finance its operations, IMB relied heavily on non-core funding from Federal Home Loan Bank (FHLB) borrowings and brokered deposits.

Source: OIG analysis of FDIC documents.

IMB's growth and profitability were fostered in part by the rapid appreciation in underlying residential real estate values that was prevalent from 2002 through 2005. However, the rate of appreciation began to slow in several markets during 2005, and that deceleration continued in 2006. The Department of the Treasury Office of Inspector General (Treasury IG) conducted a material loss review of the failure of IMB, as required under Section 38(k) of the Federal Deposit Insurance Act.¹ The Treasury IG's report stated that the primary causes of IMB's failure were largely associated with its business strategy of originating and securitizing Alt-A loans on a large scale.

More specifically, the report stated that IMB's aggressive growth strategy, use of Alt-A and other non-traditional loan products, insufficient underwriting, credit concentrations in residential real estate in the California and Florida markets, and heavy reliance on costly funds borrowed from the FHLB and brokered deposits, led to its demise when the mortgage market declined in 2007. IMB remained profitable as long as it was able to sell its loans in the secondary market. When home prices declined in the later half of 2007 and the secondary mortgage market collapsed, IMB was forced to hold loans it could not sell in the secondary market. A significant level of assets on IMB's balance sheet did not have ready market prices. Those assets were self-valued by IMB using internal financial models. As of September 30, 2006, those self-valued assets represented about 95 percent of core capital.

The non-core funding sources IMB relied upon increased the FDIC's resolution costs at the time of failure because FHLB borrowings must be repaid first, and many brokered deposits are not transferred when the FDIC sells an institution's assets. As of December 31, 2007, IMB had \$11.2 billion in FHLB borrowings and \$5.8 billion in brokered deposits for a total of \$17 billion compared to total assets of \$32.5 billion.

OTS' RESPONSIBILITY AND AUTHORITY

The OTS was the PFR for IMB from 2000 to 2008. As the PFR, OTS was statutorily responsible for conducting full-scope on-site examinations of IMB to assess IMB safety and soundness, and compliance with consumer protection laws and regulations. In addition, OTS examiners monitor the condition of thrifts through offsite analysis of regularly submitted financial data and regular contact with thrift personnel. OTS examinations and its ongoing supervisory oversight are tailored to the risk profile of each institution.

OTS uses the Uniform Financial Institution Rating System that has been developed jointly by the federal banking regulators to assign each financial institution a composite rating. The composite rating is based on the results of the on-site examination that evaluates and rates six essential components of an institution's financial condition and operations. The component factors address the adequacy of Capital, the quality of Assets, the capability of Management, the quality and level of Earnings, the adequacy of Liquidity, and the Sensitivity to market risk—collectively

¹ Under Section 38(k) a loss is material if it exceeds the greater of \$25 million or 2 percent of an institution's total assets at the time the FDIC was appointed receiver. The objectives of the IMB material loss review were to determine why IMB's problems resulted in a material loss to the insurance fund, review OTS' supervision of IMB, and make recommendations for preventing such loss in the future. The Treasury OIG report, entitled, *Safety and Soundness: Material Loss Review of IndyMac Bank, FSB*, was dated February 26, 2009 (Report No. OIG-09-032).

known as the CAMELS ratings. Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile. The composite ratings range on a scale from 1 (best) to 5 (worst), as shown in Table 2.

Table 2: CAMELS Composite Ratings

1	Sound in every respect.
2	Fundamentally sound.
3	Exhibit some degree of supervisory concern in one or more of the component areas.
4	Generally exhibit unsafe and unsound practices or conditions.
5	Exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; often contain inadequate risk management practices relative to the institution's size, complexity, and risk profile; and are of the greatest supervisory concern.

Source: FDIC's *Risk Management Manual of Examination Policies*.

As the PFR, OTS also has the authority to take informal and formal enforcement action against an institution to carry out its supervisory responsibilities. Informal enforcement actions put an institution on notice that OTS has identified problems in case formal action is needed in the future. A formal enforcement action is both written and enforceable. Guidance exists for determining whether to use an informal supervisory action or take a formal enforcement action.

The Treasury IG's material loss report stated that although OTS conducted timely and regular examinations of IMB and provided oversight through offsite monitoring, its supervision of the thrift failed to prevent a material loss to the Deposit Insurance Fund. The Treasury IG reported that IMB's high-risk business strategy warranted more careful and much earlier attention. The report further stated that OTS viewed growth and profitability as evidence that IMB management was capable, and OTS gave IMB favorable CAMELS ratings right up to the time it failed. Moreover, the OTS did not issue an enforcement action until June 2008, less than 2 weeks before IMB failed.

FDIC'S RESPONSIBILITY AND AUTHORITY

The FDIC is the PFR for state non-member banks, but has the unique role of insuring deposits for all depository institutions in the United States. In its capacity as insurer, the FDIC is responsible for regularly monitoring and assessing the potential risks at all insured institutions, including those for which it is not the PFR. To assess and monitor risk, the FDIC takes a two-fold approach – (1) reliance on supervisory activities of individual institutions and (2) research and analysis of trends and developments affecting the health of banks and thrifts broadly. For institutions like IMB, whose PFR is another agency, the FDIC relies on the examinations conducted by other regulators to determine a bank's overall condition and the risks posed to the Deposit Insurance Fund. Additionally, the FDIC, by statute, has special examination authority and certain enforcement authority for all insured depository institutions for which it is not the PFR. To assess risk at a broader level, the FDIC conducts a wide range of activities to monitor and assess risk from a regional and national perspective. At the institutional level, the FDIC monitors non-FDIC supervised institutions primarily through its Case Manager Program.

FDIC Risk Monitoring Activities From a Broad Perspective

The FDIC has three primary divisions to carry out its mission-related activities:

Division of Supervision and Consumer Protection (DSC). DSC conducts safety and soundness examinations of state non-member institutions and performs risk management activities for all insured institutions to monitor risks to the Deposit Insurance Fund.² DSC's Complex Financial Institution Program is responsible for supporting supervisory activities in large banks (defined to be institutions with total assets of at least \$10 billion). The focus of the program is to ensure a consistent approach to large-bank supervision and risk analysis on a national basis. The Large Bank Section synthesizes information from Large Insured Depository Institution (LIDI) reports, aggregates data on large banks to identify trends and emerging risks, and communicates these trends and emerging risks to FDIC senior management, the FDIC Board of Directors, other regulators, and DSC staff.

Division of Insurance (DIR). DIR assesses risks to the insurance fund, manages the FDIC's Risk-Related Premium System (RRPS), conducts banking research, publishes banking data and statistics, and analyzes policy alternatives. The division has a leading role in preparing a key set of reports delivered to the FDIC's Board of Directors. One of these reports known as the "Risk Case" summarizes national economic conditions and banking industry trends, plus emerging risks in banking. The report combines the perspectives of FDIC economists, financial and risk analysts, examiners, and case managers working through the Risk Analysis Center (RAC). The second key report prepared by DIR is known as the "Rate Case" that recommends the insurance premium schedule based on analysis, including likely losses to the fund from failures of individual institutions, expenses of resolving failing institutions, insurance fund operating expenses, growth of insured deposits, investment income, and the effect of premiums on the earnings and capital of insured institutions.

Division of Resolutions and Receiverships (DRR). DRR handles financial institution failures and liquidation of failed institution assets. The FDIC proactively identifies troubled financial institutions and begins its resolution efforts, such as valuing assets and identifying potential purchasers of those institutions before they fail. At failure, the FDIC is appointed receiver, and DRR is responsible for ensuring that customers have timely access to their insured deposits. As receiver, the FDIC manages and sells the assets.

To coordinate risk monitoring activities across the divisions, the FDIC has established the following:

Regional Risk Committees. The Regional Risk Committees review and evaluate regional economic and banking trends and risks and determine whether any actions need to be taken in response to those trends and risks. Comprised of senior regional executives and relevant staff, the committees are required to meet semi-annually. Regional Risk Committee responsibilities include:

² DSC also examines state non-member institutions' compliance with consumer protection, fair lending, community reinvestment, and other laws.

- identifying and assessing existing and emerging regional economic and banking trends and risks that may affect insured institutions;
- developing follow-up strategies and actions to address the identified issues;
- allocating resources, where necessary, to implement follow-up strategies and actions;
- preparing a Regional Risk Committee Summary Report and regional matrix for submission to the Risk Analysis Center (RAC);
- conveying and receiving information regarding identified trends and risks to and from the National Risk Committee, FDIC divisions and offices in Washington, D.C., the RAC, other regions, field examiners, and other Federal and state regulators;
- receiving and reviewing information and recommendations from the National Risk Committee and incorporating these into regional strategies, where appropriate.

National Risk Committee. The National Risk Committee, comprised of senior FDIC officials, meets on a monthly basis to identify and evaluate the most significant external business risks facing the FDIC and the banking industry. Where necessary, the committee develops a coordinated response to these risks, including strategies for FDIC-supervised and insured institutions. Among other things, the National Risk Committee receives the regional risk committee reports filed from across the country.

Risk Analysis Center. The RAC is an interdivisional forum that coordinates risk identification and prioritization among the FDIC's three primary divisions. The RAC facilitates the flow of communication between the National Risk Committee and the Regional Risk Committees in several ways, including instructing the Regional Risk Committees to review certain prescribed risk areas, and summarizing regional reports and matrices for the National Risk Committee. The RAC Web site has a variety of risk-related information, including FDIC publications and presentations available. The site offers guidance on topics such as concentrations in real estate lending and interest rate risk management.

FDIC Risk Monitoring Activities from an Individual Institution Perspective

Case managers, along with senior regional management, are generally responsible for ensuring that the level of regulatory oversight accorded to an institution is commensurate with the level of risk it poses to the Deposit Insurance Fund. Case managers regularly monitor potential risks by reviewing examination reports prepared by the PFR, analyzing data from quarterly institution Call Reports,³ and analyzing other financial and economic data from government and private sources to monitor the financial condition of an institution. The *Case Managers Procedures Manual* lists the case manager's responsibilities as follows (see Appendix III for a full description):

- Directing Supervisory Strategy
- Establishing and Maintaining a Dialogue with the Primary Regulator
- Reviewing Examination Reports, Applications, Investigations, and Correspondence

³ All regulated financial institutions are required to file quarterly financial information. For banks, this report is formally known as the *Reports of Condition and Income* but is generally referred to as the Call Report. Thrifts file a similar report known as the Thrift Financial Report or TFR.

- Initiating and Developing Corrective Programs
- Coordinating with Specialty Areas
- Preparing Management Information Reports
- Performing Offsite Monitoring and Preparing Analyses
- Keeping Abreast of Current Economic Trends

Case managers review reports of examination conducted by other regulators to determine that problems and risks have been identified and appropriate corrective actions are being taken. Case managers prepare a Summary Analysis of Examination Reports (SAER) for each institution, which is a narrative summary of the PFR's report of examination findings.

In addition to reviewing the examination reports, in the case of large institutions, like an IMB, case managers conduct comprehensive quarterly analyses of the risk profile and supervisory strategies as part of the LIDI program. The purpose of the LIDI program is to provide timely, comprehensive, and forward-looking analyses of companies with total assets of \$10 billion or more, on a consolidated entity basis.⁴ Timely and complete analysis of the risk profiles of these companies provides a proactive approach aimed at identifying and monitoring the largest risks to the insurance fund. Case managers prepare written reports that document the analysis and risk profile and supervisory strategies of large depository institutions. The analysis is comprised of four major areas:

- organizational structure and strategic focus of the company;
- overall risk profile and financial condition of the company;
- an identification and review of significant issues, current events, and challenges facing the company; and
- the review and development of a sufficient supervisory program to address the risk issues facing the company.

The FDIC developed the LIDI reports and associated rankings as an additional means to measure an institution's financial health beyond the CAMELS ratings. LIDI reports are used to inform FDIC senior management, the FDIC's Board of Directors, and other regulators about risks to the insurance fund as well as provide updates about the supervisory programs in place to respond to those risks.

The Regional Director is responsible for assigning offsite ratings to companies in the LIDI program. Table 3 describes the LIDI ratings from A (best) to E (worst). Combination ratings (e.g., A/B indicate financial condition and trends contain elements of both rating bands shown). Generally, DSC is concerned when an institution's LIDI ranking falls to C or lower. Appendix VI provides a more detailed description of the LIDI ratings.

⁴ Companies with consolidated total assets of at least \$3 billion but less than \$10 billion can be added to the LIDI Program at the discretion of the Regional Director.

Table 3: LIDI Ratings

A	–	Low risk of concern regarding ultimate risk to the insurance funds.
B	–	Ordinary level of concern regarding ultimate risk to the insurance funds. Barring unusual circumstances, regulatory intervention is unlikely.
C	–	More than an ordinary level of concern regarding ultimate risk to the insurance funds. Despite evident weakness, probability of failure or need of FDIC financial assistance in the short- to immediate-term is unlikely.
D	–	High level of concern regarding the ultimate risk to the insurance funds. There is a distinct possibility of failure or need of FDIC financial assistance if problems identified are not addressed in the short- to immediate-term.
E	–	Serious concerns regarding ultimate risk to the insurance funds: Organizational structure, financial condition, or operating performance exhibited (or are expected to exhibit in the near-term) indicate the company may not be viable.

Source: FDIC's *Case Managers Procedures Manual*.

Additionally, case managers perform offsite reviews of those institutions that appear on the Offsite Review List (ORL). The ORL is generated each quarter after the Call Report data is filed.⁵ In general, an institution is included on the ORL because its financial ratios fall outside FDIC-determined tolerances. Each institution on the ORL must have an offsite review. An offsite review with a risk level of “medium” or “high” must include a narrative that focuses on the components or elements causing the institution’s inclusion on the ORL and the reasons for the overall level or trend of risk. The narrative should conclude with a brief description of the planned supervisory strategy.⁶ Appendix V describes the various offsite monitoring systems used in generating the ORL.

In addition to the ORL, case managers must also review the RRPS. The RRPS is used to determine an institution’s FDIC deposit insurance assessment rate. The Reconciliation List identifies institutions where the CAMELS ratings are inconsistent with offsite ratios and institutions with atypical high-risk profiles among the group of institutions in the best-rated insurance premium category. If the Reconciliation List is triggered, a case manager must review the appropriateness of the risk category assigned by the RRPS.⁷

Based on their ongoing analysis, case managers prepare a problem bank memorandum, where appropriate, to document the FDIC’s concerns with an institution and the corrective action in place or to be implemented. A problem institution is defined as any insured institution that has been assigned a composite rating of 4 or 5. Generally, a 3-rated institution is not formally considered a “problem institution.” However, because of the potential risk to the Deposit Insurance Fund, a problem bank memorandum is required on larger 3-rated institutions as a means to document any concerns and plans. These ratings may result from an examination or may be assigned based upon visitations, offsite reviews, or other interim changes in a financial institution’s condition. The problem bank memorandum is also used to effect interim rating

⁵ Generally, there is a lag between the time an institution’s financial information is received and the computation of the FDIC ratios. Institutions have 30 days following the end of the quarter to file the Call Report. Offsite reviews must be completed and approved 3½ months after each call report date.

⁶ Narrative comments are recorded in Virtual Supervisory Information on the Net (ViSION), which is an internal FDIC bank supervision tracking and reporting database.

⁷ The Reconciliation List was a semi-annual review until June 6, 2007, at which time it became a quarterly review.

changes on the FDIC’s systems or if a composite rating disagreement with the primary regulator cannot be resolved.

Special Examination Authority

Section 10(b)(3) of the FDI Act provides the FDIC special examination authority (also known as back-up authority) to make any special examination of any insured depository whenever the FDIC Board of Directors determines a special examination of any such depository institution is necessary to determine the condition of the institution for insurance purposes. In January 2002, the FDIC’s Board of Directors approved an interagency agreement that established a set of principles related to use of special examination authority for those institutions that present “heightened risk” to the Deposit Insurance Fund and delegated its authority to DSC.⁸ The term “heightened risk” is defined under statute as an institution having a composite rating of 3, 4, or 5 or that is undercapitalized as defined under Prompt Corrective Action rules.⁹ Further, the FDIC may request permission from the PFR to participate in an examination for an institution that does not meet the heightened risk definition but exhibits material deteriorating conditions or other adverse developments that may result in the institution being troubled in the near-term.

Procedurally, a case manager prepares a memorandum documenting the basis for a back-up examination request and submits the request to the FDIC Regional Director or Deputy Regional Director who may accept or reject the request. If the request is based on heightened risk, the Regional Director formally notifies the PFR counterpart by sending a letter stating the FDIC would like to participate in the examination. If the request is not based on heightened risk, the process is more in the manner of a request where the FDIC Regional Director asks the PFR counterpart whether the PFR would object to the FDIC’s participation. Implicit in both of these requests is the principle of effective and efficient supervision. On a quarterly basis, the FDIC regional offices report back-up examination activity to the FDIC DSC Director in Washington. That quarterly report includes back-up examination requests that have been completed or that are in process. The report does not track recommendations for back-up examination requests that are not approved by FDIC regional management.

Principles That Underlie Use of Back-up Authority
<ul style="list-style-type: none">– All back-up examination activities will be conducted in a manner to minimize costs to the industry, regulatory burden, and duplication of effort.– FDIC staff will meet and coordinate with the PFR before engaging in any back-up examination activity.– To the fullest extent possible, back-up examination activities should be conducted concurrently with the PFRs’ regularly scheduled examination.– The FDIC will not prepare a separate report of examination, or other similar report to bank management, except where enforcement action by the FDIC is anticipated.
<p>Source: FDIC’s <i>Case Managers Procedures Manual</i>.</p>

In the event that the FDIC and the PFR disagree as to the appropriateness of the FDIC’s participation, the respective agency representatives to the Federal Financial Institutions

⁸ January 29, 2002 Interagency Agreement, “*Coordination of Expanded Supervisory Information Sharing and Special Examinations*.”

⁹ 12 U.S.C. §1820(b)(3).

Examination Council (FFIEC)¹⁰ will determine whether FDIC participation is appropriate. In the event the agency representatives cannot agree, the FDIC Chairman and the principal of the PFR will make the determination.

Enforcement Action Authority for Institutions Not Supervised by the FDIC

The FDIC is authorized under Section 8(t) of the Federal Deposit Insurance Act to engage in back-up enforcement action.¹¹ In this capacity, the FDIC generally has the same powers with respect to any insured depository institution and its affiliates as the appropriate Federal banking agency has with respect to the institution and its affiliates. The FDIC may recommend in writing that an institution's PFR take a range of enforcement actions authorized under the FDI Act with respect to any insured depository institution or any institution-affiliated party, based on an examination by the FDIC or the PFR. The recommendation must be accompanied by a written explanation of the concerns giving rise to the recommendation. If, within 60 days of such recommendation, the institution's PFR does not take the enforcement action recommended by the FDIC or provide an acceptable plan for responding to the concerns, the FDIC may petition the FDIC Board of Directors for such enforcement action to be taken. Only after Board approval may the FDIC take action in its capacity as insurer. However, the composition of the FDIC Board, which includes the Director of OTS and the Comptroller of the Currency, essentially puts the enforcement decision back into the hands of the PFR that was reluctant to take action in the first place. The statute provides for a similar exercise of the FDIC's authority in exigent circumstances without regard to the 60-day time period; however, such circumstances also require approval of the FDIC Board of Directors prior to any action being taken.

Deposit Insurance Assessments

Prior to the passage of the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Act Conforming Amendments of 2005 (collectively referred to as the Reform Act) the FDIC was statutorily required to set assessments semiannually. Specifically, the FDIC Improvement Act of 1991 (FDICIA) required that the FDIC establish a risk-based assessment system. To implement that requirement, the FDIC adopted by regulation a system that placed institutions into risk categories based on two criteria: (1) capital levels and (2) supervisory ratings, as illustrated in Table 4. In practice, the subgroup evaluations were generally based on an institution's composite CAMELS rating. Generally, institutions with a CAMELS rating of 1 or 2 were put into supervisory subgroup A. Supervisory subgroup B generally included institutions with a CAMELS composite rating of 3; and supervisory subgroup C generally included institutions with CAMELS composite ratings of 4 or 5.

¹⁰ According to the FFIEC Web site, the Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), FDIC, National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and OTS, and to make recommendations to promote uniformity in the supervision of financial institutions. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC includes representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State Savings Supervisors (ACSSS), and the National Association of State Credit Union Supervisors (NASCUS).

¹¹ 12 U.S.C. §1818(t).

Table 4: Risk-Based Assessment Matrix Effective Until January 2007

Capital Group	Supervisory Group		
	A	B	C
1. Well Capitalized	1A	1B	1C
2. Adequately Capitalized	2A	2B	2C
3. Undercapitalized	3A	3B	3C

Source: 12 CFR Part 327, Final Rule Supplemental Information.

A risk-based system is defined as one based on an institution’s probability of causing a loss to the Deposit Insurance Fund due to the composition and concentration of the institution’s assets and liabilities, the amount of loss given failure, and the revenue needs of the fund. Provisions in the Reform Act continued to require that the assessment system be risk-based but allowed the FDIC to define risk broadly. Under the rule adopted by the FDIC to implement the Reform Act, deposit insurance assessments are collected after each quarter ends—which was intended to allow for consideration of more current information than under the prior rule. Effective January 1, 2007, the nine risk classifications in the risk-based assessment matrix were consolidated into four risk categories. However, the implementing regulation continued to use capital ratios and supervisory ratings to determine an institution’s risk category. Table 5 shows the relationship between the old nine-cell matrix and the new risk categories.

Table 5: New Risk Categories Effective January 2007

Capital Group	Supervisory Group		
	A	B	C
1. Well Capitalized	I		
2. Adequately Capitalized		II	III
3. Undercapitalized		III	IV

Source: FDIC’s Website – *Deposit Insurance Assessments – Key Provisions Pertaining to Risk-based Assessments*.

The amount each institution is assessed is based upon factors that include the amount of the institution’s domestic deposits as well as the degree of risk the institution poses to the insurance fund. For large institutions (generally those institutions with \$10 billion or more in assets) that have long-term debt issuer ratings, base assessment rates are determined from weighted average CAMELS component ratings and long-term debt issuer ratings. For larger Risk Category I institutions, additional risk factors will be considered to determine if the assessment rates should be adjusted up to a ½ basis point higher or lower. This additional information includes market data, financial performance measures, considerations of the ability to withstand financial stress, and loss severity indicators.

RESULTS IN BRIEF

In its role as insurer, the FDIC identified and monitored the risks that IMB presented to the Deposit Insurance Fund primarily through two means: (1) broad risk monitoring activities conducted by DIR and FDIC risk committees and (2) analysis of IMB-specific data. Additionally, the FDIC participated in its back-up examination capacity in on-site IMB examinations with the OTS in 2001, 2002, 2003, and again shortly before IMB failed in 2008.

The FDIC completed various reports and analyses of IMB, including SAERS, quarterly LIDI reports, and required reconciliations generated from the FDIC's offsite monitoring systems and RRPS, and identified risks associated with IMB's operations. The FDIC's risk committees' analyses also raised broad concerns about the impact that an economic slowdown could have on an institution like IMB that was heavily involved in securitizations and subprime lending. Nevertheless, FDIC officials consistently concluded that despite its high-risk profile, IMB posed an ordinary or slightly more than ordinary level of risk to the insurance fund until August 2007 when the FDIC began to understand the implications that the historic collapse of the credit market and housing slowdown could have on IMB's future viability.

Our evaluation of the FDIC role in monitoring IMB can be broken into three periods as follows:

Phase 1: 2001 through 2003

In the first 3 years of IMB operations, the FDIC identified a number of risks at IMB, especially with respect to origination and securitization of mortgages. To better understand the risks IMB posed to the Deposit Insurance Fund, the FDIC exercised its back-up examination authority in 2001, 2002, and 2003. The FDIC's use of back-up examination authority was supported by OTS. Significantly, during the 2001 examination, the OTS and the FDIC disagreed on IMB's composite CAMELS rating. The FDIC concluded that IMB should be assigned a 3 rating while OTS proposed a 2 rating. Ultimately, after the disagreement was elevated to the FDIC and OTS headquarters level, IMB received a composite 3 rating.

Phase 2: 2004 through Mid-2007

During this period, FDIC monitoring tools identified potential risks because of IMB's significant growth. Consistent with interagency guidelines, but counter to recommendations made by the FDIC's SFRO staff that were supported by the OTS, the DSC SF Regional Director determined in 2004 that continuation of back-up examination authority was not warranted. Back-up examination authority was not formally requested again until late 2007. FDIC analysis during this period relied on OTS on-site examination results, which indicated that, despite some concerns, IMB was fundamentally sound and IMB earnings adequately mitigated any potential risks. Importantly, the continuity at the case manager position was not consistent during this phase. Three different case managers were assigned to monitor IMB during an 18-month period. Although regional officials tried to ensure a smooth transition among the case managers, a November 2007 DSC internal review report stated that achieving continuity of case managers is important because the case manager builds the relationship with the institution and the PFR, and develops a robust understanding of each company's operations, risks, and business lines.

Phase 3: Mid-2007 through Mid-2008

The liquidity stress suffered by the nation's largest mortgage lender, Countrywide, in mid-2007 served as a catalyst for the FDIC to reassess IMB and other financial institutions with similar originate-to-sell business models.¹² When the FDIC noted problems with IMB in the third quarter of 2007, the FDIC exercised its back-up examination authority and downgraded its LIDI rating of IMB in 2007 and 2008. Changes to the LIDI rating were reflected in IMB's insurance premium assessment beginning in 2008. Further, although there was a noticeable deterioration in IMB in the fourth quarter of 2007 and into 2008, the FDIC did not suggest that OTS take, or itself take, any enforcement action against IMB. Notably, the FDIC's analysis and conclusions of IMB's first quarter 2008 financial data were affected by a capital contribution adjustment that was permitted by OTS. Had the capital contribution not been reflected in the first quarter data: (1) IMB would have been required to request a waiver from the FDIC to continue to receive brokered deposits and (2) the value of assets pledged as collateral to secure FHLB advances would have been reduced, thereby limiting the amount of FHLB advances and possibly the cost of IMB's failure.

Appendix IV presents a more detailed timeline of significant events relevant to IMB. The Evaluation Results also describe within each phase the FDIC's broad and IMB-specific risk monitoring activities. Because this evaluation focused on the FDIC's role in monitoring one institution, we are not in a position to reach conclusions or make recommendations on the design and implementation of the FDIC's risk monitoring activities, but we do offer some matters for management's consideration as it evaluates the lessons learned from recent banking industry events.

¹² Countrywide Financial Corporation and its subsidiaries were engaged in mortgage lending and other real estate finance-related businesses, including mortgage banking, banking and mortgage warehouse lending, dealing in securities, and insurance underwriting. In July 2007, Countrywide was the nation's largest mortgage lender with \$200 billion in assets, 62,000 employees and 900 offices.

EVALUATION RESULTS

Phase 1: 2001 through 2003 - FDIC Actively Engaged in Monitoring IMB

During this phase, the rate of IMB's growth, its significant concentrations in subprime and Alt-A mortgages, and its reliance on securitization and non-core deposits as a source of funding led to the FDIC's participation with OTS in on-site examinations. Indeed, FDIC examiners spent 8,096 hours in a back-up capacity at IMB during that 3-year period, a time commitment that was far greater than the hours spent at any other FDIC-insured institution in a back-up role during that period. In addition, FDIC analysis at the national and regional level had identified concerns related to levels of consumer debt, trends in the housing market, subprime mortgages, and securitizations, which were areas relevant to front-line supervision of IMB. Table 6 provides an overview of IMB's financial condition and corresponding supervisory ratings, and shows that IMB assets nearly doubled during this period and IMB was profitable. Supervisory ratings assigned by the OTS generally indicated that IMB was fundamentally sound.

Table 6: Financial and Supervisory Data for IMB – 2001 to 2003

	2001	2002	2003
IMB Assets (\$ Billions)	\$7.4	\$9.5	\$13.1
IMB Net Income (\$ Millions)	\$119	\$143	\$180
OTS CAMELS Composite Rating	3	2	2
FDIC LIDI Rating	*	*	B/C
FDIC Insurance Premium Rating	1A	1A	1A

Source: OIG analysis of FDIC documents.

*FDIC did not use the LIDI rating system for the 2001 and 2002 reports.

FDIC RISK MONITORING ACTIVITIES – BROAD PERSPECTIVE

Between 2001 and 2003,¹³ DIR risk assessments and quarterly banking profiles identified concerns about a number of issues, including:

- consumers' ever-increasing debt load, the expansion of adjustable rate mortgages, and a potential housing bubble;
- subprime and high loan-to-value (HLTV) lending as a risk in the event that the United States economy suffered a significant recession; and
- pricing and modeling charge-off risk with respect to the originate-to-sell model of the mortgage business.

In January 2002, DIR noted that non-recession-tested lending programs such as subprime lending and HLTV lending may pose the biggest threat to consumer loan portfolio credit quality in a slowing economy. In May 2003, DIR reported that there was a concern about the extent to

¹³ The regional risk committees were in existence in this period but the committees were not formally chartered until January 2003 and the regional risk committee reports were not standardized; accordingly, we are not providing Regional Risk Committee information for this phase.

which lenders' scoring models under-predicted losses during the 2001 recession. DIR noted that many subprime lenders experienced loss rates higher than their models predicted and that some consumer lending business models had been found to be inadequate, including those that relied on the securitization market for funding and were, therefore, sensitive to market pricing changes.

FDIC RISK MONITORING ACTIVITIES – IMB-SPECIFIC

During this first phase, the FDIC was actively engaged in supervising IMB because of IMB's risk profile. With a minor exception related to a quarterly LIDI report in 2001, the case manager completed required analysis related to IMB, and the completed LIDI reports identified a number of risks. Table 7 provides an overview of the FDIC's monitoring activities for IMB and illustrates when the FDIC's offsite monitoring tools flagged IMB for review.

LIDI Reporting and Offsite Monitoring

During this time period, one of the quarterly LIDI reports for 2001 was missing, but as discussed later, the impact of not completing the LIDI was lessened because the FDIC was at IMB working with OTS in a back-up examination capacity. The LIDI reports prepared during this phase indicated that IMB had less than adequate capital to support its high-risk profile and aggressive growth, excessive levels of underwriting and documentation deficiencies, high levels of subjectively valued assets, subprime lending, and reliance on non-core FHLB borrowing to finance its operations. One of the LIDI reports prepared in the third quarter of 2001 was prophetic in the assessment of IMB and stated; “[a]n economic recession could prove very challenging for the company given their short operating history ... and untested products in an economic downturn.”

Table 7: Snapshot of the FDIC's Monitoring and Supervision Activities of IMB – 2001 to 2003

	2001	2002	2003
FDIC Completed Required Reports (including LIDI)	No	✓	✓
FDIC Problem bank memorandum	9/21	4/05	
SAER Completed	✓	✓	✓
Quarterly (Qtr) ORL Triggered			2 Qtrs
Reconciliation List Triggered	7/01		1/01 7/01
Backup Exam Requested	✓	✓	✓

Source: OIG analysis of FDIC documents.

The FDIC's SFRO also issued two problem bank memoranda. As discussed in the Background section, a problem bank memorandum can be issued for reasons beyond the identification of a problem institution (defined to be assigned a composite rating of 4 or 5). In the case of IMB, the problem bank memorandum issued September 21, 2001 communicated to senior FDIC management the nature of the rating disagreement between the FDIC and OTS based on the 2001 on-site examination work done by both OTS and the FDIC. The second memorandum, dated April 5, 2002, described the additional work performed by the FDIC at IMB in 2001 for high-risk areas that were not fully covered in the examination, namely, asset quality for subprime and construction loans, appraisals, underwriting, and securitization.

IMB also appeared on the ORL in the third and fourth quarter of 2003 because IMB exceeded multiple risk thresholds, including those related to asset growth and the degree of reliance on volatile funding sources, such as securitizations, brokered deposits, and FHLB borrowings. However, the case manager analysis noted that the September 2003 OTS examination, in which

the FDIC participated, had determined that the bank's liquidity and funds management was properly managed, monitored, and controlled.

Further, IMB appeared on the RRPS reconciliation list for three semiannual reporting periods during this phase because of IMB's significant growth; credit exposure from assets sold and securitized that exceeded the FDIC's threshold of 20 percent of tier 1 capital; and subprime loans that exceeded the FDIC's threshold of 25 percent of tier 1 capital. In addressing IMB's appearance on the Reconciliation List and the associated risk, the FDIC case manager reviewed and considered IMB's Uniform Thrift Performance Report, Securities and Exchange Commission filings, OTS reports of examination, FDIC offsite review information, an FDIC visitation memorandum, and correspondence and concluded that the supervisory subgroup assignment of "A" was appropriate. Group "A" is defined to consist of financially sound institutions with only a few minor weaknesses and generally corresponds to the PFR's composite rating of 1 or 2.

The FDIC's Participation in On-site Examinations

Collectively, the problems noted by FDIC monitoring tools prompted the FDIC to request back-up examination authority for IMB in 2001, 2002, and 2003. In the 2001 examination, the FDIC and OTS disagreed on the composite CAMELS rating. Specifically, OTS planned to assign IMB a CAMELS composite rating of 2; however, the FDIC thought IMB should receive a 3 rating. After elevating the ratings disagreement to the headquarters level of the FDIC and the OTS, the OTS agreed with the FDIC and assigned a "3" CAMELS composite rating to IMB. In the July 2002 examination, the OTS and the FDIC found IMB to be fundamentally sound and agreed on the assignment of a 2 CAMELS composite rating. However, in that examination the OTS noted continued problems with risk management. In the September 2003 examination, the OTS and the FDIC agreed to assign IMB a CAMELS composite 2 rating but continued to note risk management concerns especially with the valuation of variable cash flow instruments, which include mortgage servicing rights and residual interests in securities. Each of the three reports of examination included matters for IMB management's attention and corrective action but did not recommend any enforcement actions against IMB.

The FDIC's participation on these examinations required that a number of FDIC and OTS capital markets experts review models developed by IMB that assigned values to certain balance sheet assets. In fact, documents we reviewed indicated that the OTS specifically requested the FDIC's assistance in the examination of IMB in order to obtain FDIC capital markets specialists' expertise in the valuation of mortgage servicing rights and mortgage-backed securities. The FDIC's back-up examinations during this period were significant for several reasons.

- FDIC regional capital markets personnel were able to review the assumptions used in the valuation models that IMB used to determine the value of assets on its balance sheet that had no established market price. FDIC regional capital markets personnel noted that on-site review of the models was significant because that was the only way to review and understand the underlying assumptions in the valuation models.

- The FDIC and OTS developed a close working relationship during this timeframe, and FDIC capital markets personnel supplemented the limited availability of OTS capital markets personnel. Emails and letters from the OTS regional director to the FDIC regional director note the importance of the FDIC’s capital market assistance and the OTS’ appreciation of that assistance.

Phase 2: 2004 through Mid-2007 – The FDIC Did Not Participate in On-site Examinations

Significantly, during this period, IMB continued to rely heavily on volatile funding sources such as brokered deposits and FHLB advances to fund its growth. The FDIC’s analysis of banking and economic trends at a national and regional level continued to identify risks associated with areas that were relevant to IMB operations. In 2004, the FDIC’s SFRO Regional Director determined that continued participation in the on-site examination was not warranted. The Regional Director’s decision was consistent with the interagency principles related to the use of back-up examination authority. However, this position ran counter to recommendations made by the case manager for IMB and the capital markets specialist that were supported by the OTS Regional Director to continue participating in the on-site examinations. Consequently, the FDIC’s assessment of IMB shifted to reliance on the results of OTS’ on-site examinations and the FDIC’s offsite monitoring systems. Table 8 provides an overview of IMB’s financial condition and corresponding supervisory ratings for this phase.

Table 8: Financial and Supervisory Data for IMB – 2004 to mid-2007

	2004	2005	2006	1 st Qtr. 2007	2 nd Qtr. 2007
IMB Assets (\$ Billions)	\$15.6	\$20.3	\$28.7	\$29	31.3
IMB Net Income (\$ Millions)	\$183	\$307	\$357	\$59	\$50
OTS CAMELS Composite Rating	2	2	2	2	2
FDIC LIDI Rating	B/C	B/C	B/C	B/C	Incomplete
FDIC Insurance Premium Rating	1A	1A	1A	1A	1A

Source: OIG analysis of FDIC documents.

While assets nearly doubled during this period and IMB remained profitable, the data suggests the growth rate was beginning to slow down by 2007, and income was starting to decline. OTS’ on-site CAMELS rating and the FDIC’s offsite ratings consistently indicated that IMB was fundamentally sound and posed an ordinary to more than ordinary level of risk to the Deposit Insurance Fund.

FDIC RISK MONITORING ACTIVITIES – BROAD PERSPECTIVE

During this period, FDIC regional and national risk management committees and offices reported concerns with respect to subprime and non-traditional lending. For example, the SFRO Regional Risk Committee and the FDIC’s National Risk Committee reported an escalated level of concern related to prime and subprime lending and large bank risks, as shown in Table 9.

Table 9: Excerpts from Selected SFRO Risk Committee Reports*

Risk Issue	Oct 2005	April 2006	Sept 2006	March 2007
Prime Lending	Significant	Moderate	Moderate	Significant
Subprime Lending	Limited	Limited	Limited	Significant
Large Bank Risks	Moderate	Significant	Significant	Significant

Source: OIG review of DSC risk management reports.

*Note: The table presents color-coded information from the Risk Committee Reports about the FDIC’s level of concern with a particular issue with yellow, orange, and red corresponding to a medium, elevated, and high level of concern, respectively. The table also presents an assessment of the exposure (limited, moderate, and significant) that measures the likely impact of an adverse risk area on the region’s banking industry.

The SFRO regional risk committee reports recommended supervisory strategies to address identified risks, ranging from issuing publications and conducting research on relevant topics to prioritizing examinations and conducting offsite monitoring. In some instances, the reports also recommended large bank policy changes or additional training for examiners related to prime and subprime lending.

Also during this phase, DIR’s semiannual rate cases began raising concerns about a potential housing bubble and signs of a housing slowdown. Specifically, in November 2006, DIR reported emerging signs of potential credit distress among holders of subprime ARMs and noted that there was a high degree of leverage on the part of households and an unprecedented reliance on non-traditional mortgage products that could amplify the adverse effects of a housing slowdown. DIR also identified increasing risk in the derivative markets and the complex and opaque positions taken by the fast-growing hedge fund sector and the ability of the financial markets to absorb the shock of disruption or collapse in this sector. However, in November 2006, DIR reported that the financial health of the banking industry remained very good, earnings were at record levels, capital was historically high, and loan performance remained at record strong levels.

FDIC RISK MONITORING ACTIVITIES – IMB-SPECIFIC

During this phase, the SFRO reassigned IMB among a number of case managers as a result of internal reorganizations and individual retirements. The case managers completed required analyses related to IMB, and LIDI reports continued to identify risks but concluded based on OTS satisfactory examination results that risks were sufficiently mitigated and that the FDIC could continue to monitor IMB offsite. Table 10 provides an overview of the FDIC’s monitoring activities for IMB and illustrates when the FDIC’s offsite monitoring tools flagged IMB for review.

FDIC Offsite Analysis of IMB

The LIDI reports consistently note that IMB had continued weaknesses in control over its self-valued assets and that IMB's credit risk for subprime and Alt-A mortgages was higher than traditional thrifts. The fourth quarter 2005 LIDI report began to note that the pace of mortgage originations was forecasted to decrease. Despite these concerns, the case managers' recommended supervisory strategy was to continue periodic discussions with OTS and monitor IMB through the FDIC's Offsite Review Program.

The case managers completed quarterly LIDI reviews, as required, consistently rating IMB a "B/C" signifying that while the likelihood of near-term regulatory intervention was unlikely, the institution was more susceptible to adverse events and that regulatory intervention may be required under stress conditions.

Although the FDIC did not participate in the on-site examinations, FDIC case managers completed SAERs of OTS' three safety and soundness reports of examination from 2004 to the second quarter of 2007. Each of the OTS reports of examination consistently stated that the OTS found IMB to be fundamentally sound and rated IMB a CAMELS composite 2. The OTS' primary concern at IMB during 2004 was improving and enhancing risk management and reporting for mortgage servicing rights and residual interest securities. For 2005, the OTS recommended minor policy and practice enhancements, including building out its market risk framework throughout the bank's business units. Finally, the 2007 examination cited problems with IMB's internal controls for its Conduit Division that purchased pools of mortgage loans. During this period, all three OTS reports of examination included corrective actions for IMB management's attention but did not recommend formal or informal enforcement actions.

Significantly, the Treasury IG's material loss review noted a number of instances where the OTS did not investigate known underwriting problems, failed to ensure that problems with appraisals were corrected, and mistakenly determined that IMB's growth and profitability showed IMB's management was capable of mitigating known risks. Further, as described in more detail below, the FDIC case managers who directed the FDIC's supervisory strategy for IMB may not have fully understood risk associated with IMB, as their tenure on IMB ranged from 2 to 12 months during this period.

IMB's consistent and significant growth triggered multiple offsite monitoring systems, requiring case managers to perform seven quarterly offsite reviews of IMB during 2004, 2005, and 2006. In particular, IMB triggered:

Table 10: Snapshot of the FDIC's Monitoring and Supervision Activities of IMB – 2004 to mid-2007

	2004	2005	2006	1 st Qtr. 2007	2 nd Qtr. 2007
FDIC Completed its Required Reports	✓	✓	✓	✓	No
FDIC Problem Bank Memorandum					
SAER Completed	✓	✓	n/a	✓	n/a
Quarterly (Qtr) ORL Triggered	3 Qtrs	2 Qtrs	2 Qtrs		
Reconciliation List Triggered	1/01 7/01	1/01 7/01	1/01		
Back-up Examination Requested					

Source: OIG Analysis of FDIC documents.

- the Growth Monitoring System (GMS), which identifies institutions with asset growth in the 98th to 99th percentile range of peer institutions, and
- the FDIC’s Real Estate Stress Test (REST) threshold, which models the impact of a regional recession on a financial institution’s real estate portfolio.

FDIC case manager comments in DSC’s Virtual Supervisory Information on the Net (ViSION) system, documenting the results of the offsite reviews, presented an explanation of the factors and growth rates requiring the offsite review and noted IMB’s use of higher risk funding sources, such as FHLB advances. The ORL comments generally noted the fact that OTS examinations assigned IMB a 2 CAMELS composite rating and, accordingly, case managers recommended continuing to monitor IMB through the offsite and LIDI programs. IMB also continued to appear on the FDIC’s Quarterly Lending Alert (QLA) report during this phase because the level of subprime loans exceeded 25 percent of tier 1 capital. While IMB was not highlighted as one of the top 10 subprime lenders, IMB’s ratio of subprime loans to tier 1 capital was consistently in the 50-percent range during this phase. The QLA is a DSC internal reporting mechanism used to identify those insured institutions engaged in lending activities that inherently pose an increased risk to the institutions, and thereby, the insurance fund.

As discussed earlier, the case managers play a critical role in assessing the risk an institution poses to the Deposit Insurance Fund. The FDIC assigned five individual case managers to monitor IMB from 2004 to mid-2007 as illustrated in Table 11. These changes resulted from regional office reorganizations and workload imbalances where a case manager had too many institutions in his/her portfolio. In some instances, the case managers monitored IMB for only a few months.

Table 11: Tenure of IMB Case Managers

Case Manager	Dates Assigned to IMB	No. of Months
1	09/16/2000 to 09/27/2005	60
2	09/27/2005 to 01/25/2006	4
3	01/25/2006 to 03/28/2006	2
4	03/28/2006 to 3/06/2007	12
5	03/06/2007 to 07/11/2008	16

Source: OIG review of FDIC ViSION documents.

We identified no FDIC guidance addressing the transition of oversight between existing and new case managers; therefore, the preparation for such a transition is dependent on the individuals involved. One of the case managers stated that at the time of the transfer of IMB monitoring duties, he had limited time to come up to speed on IMB because of his 25-30 institution portfolio and a high-profile case that required significant time. DSC acknowledged the SFRO had experienced reorganizations and management changes. For example, the SFRO had four Regional Directors during the period 2001 through 2008. DSC SFRO officials indicated that the region worked to ensure continuity during case manager changes. In at least one case, the fourth IMB case manager continued to oversee IMB while the fifth case manager became familiar with the bank to ensure a smooth transition. DSC noted that it is customary for case managers to meet when cases are being transferred to ensure continuity and determine how to complete work in process.

According to an FDIC Internal Review Report of the SFRO issued in September 2007, this lack of continuity in case managers was not isolated to IMB. The report notes that four institutions with elevated risk profiles for subprime and non-traditional mortgages experienced continual rotation of case managers, primarily because of workloads, retirements, and reassignments.¹⁴ Further, the report concluded that it would be advisable for DSC to seek continuity of case managers because the case manager builds the relationship with the bank and the PFR, and develops a robust understanding of each company's operations, risks, and business lines. There is a risk with multiple changes in assignment of IMB monitoring that case managers may not have had a full understanding of the extent of underlying risks at IMB.

No Participation in OTS On-site Examinations:

In 2004, in response to the risks identified by the FDIC monitoring tool information, both the FDIC case manager and regional capital markets expert requested continued back-up examination authority for IMB, and that request was supported by the OTS Regional Director in a letter to the FDIC SFRO Regional Director.

However, the FDIC SFRO Regional Director determined that the need to participate with OTS on the on-site 2004 examination was not warranted. Documents we reviewed indicated that the Regional Director did not believe that the FDIC had valid business reasons to exercise its back-up examination authority. We were unable to interview the regional director in place in 2004 because that individual has since retired from the FDIC.

Regional FDIC officials told us that the Regional Director denied their request because, consistent with the underlying requirements for back-up examinations, CAMELS composite 2-rated institutions such as IMB were generally not considered candidates for back-up examination. Further, at the time, there was concern that the FDIC was effectively subsidizing the OTS team by providing personnel for OTS examinations. FDIC Headquarters personnel in Washington were unaware of the 2004 request and denial of back-up authority for IMB because the FDIC only requires the reporting of approved requests; denials of back-up examination requests are not reported to FDIC headquarters.

Excerpts from Capital Markets Specialist's Request to Continue Back-up Examinations

In a July 30, 2004 email to the FDIC SFRO Regional Director requesting back-up examination authority, the FDIC capital markets specialist listed four reasons to be onsite at IMB:

- significant earnings decline due to reversal of aggressive accounting,
- large hedging loss in 2Q2004,
- increasing credit risk profile, and
- IMB's purchase of Financial Freedom, a reverse mortgage lending subsidiary.

He concluded his e-mail stating "I think these are four valid reasons for engaging in backup examination activity, particularly since the OTS has requested and begged for our capital markets expertise on site. In my humble opinion, this institution, despite the CAMELS rating, poses much more risk to the FDIC insurance fund than [Bank x], where we are preparing to engage in backup activity ([Bank x] has \$10 million in insured deposits)."

The SFRO officials we talked to stated that this decision impacted the FDIC in two ways.

¹⁴ The four institutions included IMB; Countrywide, Federal Savings Bank; Downey Savings and Loan, F.A.; and one other open institution.

- First, the FDIC “lost its eyes and ears” at IMB, especially with respect to the review of models that IMB used to value its assets during a period of rapid growth. Asset valuation was an important issue at IMB because a large portion of IMB’s assets did not have a market price and, therefore, were dependent on IMB’s models to determine their value. Because the Corporation did not participate in the examinations from 2004-2007, the FDIC did not have a capital markets specialist on-site to review IMB models.
- Second, the working relationship the FDIC had established with OTS changed. The OTS no longer requested FDIC capital markets assistance, and communication between FDIC case managers and OTS was less frequent.

There is one indication in an April 26, 2007 Regional Capital Markets Exposure Report that the case manager assigned to IMB highly recommended exercising back-up examination authority for the next OTS examination starting in January 2008. FDIC regional office personnel made a formal request for back-up examination authority in November 2007.

Phase 3: Mid-2007 through Mid-2008 - FDIC Resumes On-Site Presence and Evaluates IMB’s Viability

During this phase, IMB’s asset growth stalled, and the bank experienced significant quarterly losses. The FDIC became increasingly more engaged in monitoring the condition of the bank. Additionally, in mid-2007, credit ratings agencies took historical downgrade action on the entire sector of mortgage-backed securities after an increasing number of subprime borrowers began to default on their loans. Those downgrades effectively shut down the market for mortgage-backed securities and disrupted the originate-to-sell business models, leaving companies with unexpected assets on their balance sheets that they could not sell.

Countrywide Problems Become Public

On August 9, 2007, Countrywide issued a press release stating that market disruptions could affect its earnings and financial condition. Countrywide indicated that it was unable to sell its private label mortgage-backed securities and was suffering a liquidity crisis that required it to draw down an \$11.5 billion line of credit from 40 banks and receive a \$2 billion investment from Bank of America.

IMB and other large institutions, like Countrywide, relied on the mortgage origination and securitization pipeline to finance their operations, and the tumult in the debt markets critically impacted Countrywide’s ability to secure funding. The liquidity events suffered by Countrywide were relatively sudden and there was concern that Countrywide could fail. FDIC officials stated that Countrywide was a catalyst for FDIC management to identify and concentrate additional supervisory efforts on similarly-situated financial institutions, including IMB. After identifying IMB as having risks similar to Countrywide, the FDIC took a number of specific actions to increase its monitoring of IMB, including resuming an on-site presence at IMB and developing and applying a capital needs model to assess IMB’s viability as a going concern.

However, the FDIC did not lower IMB's deposit insurance premium rating until 2008 nor did the FDIC request that the OTS take any enforcement action against IMB or pursue its own enforcement actions against IMB. Table 12 provides an overview of IMB's financial condition and corresponding supervisory ratings during this phase.

Table 12: Financial and Supervisory Data for IMB – Mid-2007 to mid-2008

	3 rd Qtr 2007	4 th Qtr 2007	1 st Qtr 2008	2 nd Qtr 2008
IMB Assets (\$ Billions)	\$33.5	\$32.5	\$32	\$30.7
IMB Net Income (\$ Millions)	\$(183)	\$(491)	\$(168)	n/a
OTS CAMELS Composite Rating	2	2	3	5
FDIC LIDI Rating	C	D	E	n/a
FDIC Insurance Premium Rating	1A	1A	1B	3C

Source: OIG analysis of FDIC documents.

**FDIC RISK MONITORING
ACTIVITIES – BROAD
PERSPECTIVE**

During this period, the concerns related to subprime and non-traditional lending and the use of volatile funding sources reported by FDIC regional and national risk management committees and offices in prior periods were heightened. Table 13 presents excerpts from the San Francisco Regional Risk Committee and the FDIC's National Risk Committee reports related to prime and subprime lending and large bank risks.

Table 13: Excerpts from Selected SFRO Risk Committee Reports*

Risk Issue	Oct 2007	March 2008
Prime Lending	Significant	Significant
Subprime Lending	Significant	Significant
Large Bank Risks	Significant	Significant

Source: OIG review of DSC risk management reports.

*Note: The table presents color-coded information about the FDIC's level of concern with a particular issue with yellow, orange, and red corresponding to a medium, elevated, and high level of concern, respectively. The table also presents an assessment of the exposure (limited, moderate, and significant) that measures the likely impact of an adverse risk area on the region's banking industry.

Among other things, the SFRO Regional Risk Committee reports recommended supervisory strategies to address identified risks, including monitoring institutions with elevated exposure to subprime and non-traditional mortgages; participating in OTS examinations and holding quarterly management meetings with OTS to discuss large thrift issues; and improving information sharing between regulators to enable proper monitoring of risks.

In the May 2007 risk case, DIR reported that the financial health of banks remained strong but identified a number of issues warranting monitoring. These included (1) the performance of mortgage loans, particularly non-traditional and subprime; (2) earnings performance and net interest margin compression, in particular at small banks; (3) commercial real estate concentrations, especially in construction and development lending; and (4) innovations in financial markets, credit risk transfer, and the opaqueness of structured products. The October 2007 and May 2008 risk cases reported significant declines in bank industry earnings and historic levels of non-current mortgage loans and loan charge-offs.

FDIC RISK MONITORING AND SUPERVISORY ACTIVITIES – IMB-SPECIFIC

LIDI and Offsite Analysis of IMB

The FDIC lowered IMB’s LIDI rating from a B/C to a C in the third quarter 2007, meaning that while IMB was more susceptible to adverse events, the likelihood of near-term regulatory intervention was low under current conditions, but could be required under certain stress events. DSC further downgraded IMB’s LIDI rating to a D in the fourth quarter 2007, indicating that formal or informal regulatory action appeared likely in the near-term or had already occurred. The LIDI report showed deterioration at IMB, with most of the financial aspects of IMB operations under significant stress. The report further noted a continued increase in the number of non-performing assets and a projection that 50 percent of IMB’s \$1.2 billion in construction loans would be non-performing by the end of the year.

The first quarter 2008 LIDI report indicated that IMB’s risk exposure was complicated by the large quantity of non-traditional mortgages that IMB was unable to sell in 2007; noted problems with IMB’s financial condition; and downgraded the LIDI rating to an E, indicating that IMB faced significant exposure to adverse business, financial, or economic conditions that could lead to pronounced uncertainties related to the bank’s ongoing viability. The report considered IMB a potential failure for first quarter 2009, emphasizing its high liquidity stress, poor asset quality, inadequate capital, and poor earnings.

During the first three quarters of 2007, IMB was not included on the ORL. As previously discussed, the ORL is primarily focused on 1- and 2-rated institutions and the ORL flags institutions that have a 35-percent probability of a downgrade or institutions that are experiencing rapid growth. During that time period, the FDIC’s offsite system assigned IMB a less than 21-percent probability of downgrade.¹⁵

Table 14: Snapshot of the FDIC’s Monitoring and Supervision Activities of IMB – mid-2007 to mid-2008

	3 rd Qtr 2007	4 th Qtr 2007	1 st Qtr 2008	2 nd Qtr 2008
Completed Required Reports	✓	✓	✓	✓
FDIC Problem Bank Memo			1/25	6/09
SAER Completed	n/a	n/a	n/a	✓
ORL Triggered				
Reconciliation List Triggered				
Back-up Exam Requested		✓		

Source: OIG analysis of FDIC documents.

¹⁵ In February 2009, the FDIC OIG Office of Audits issued a report, *FDIC’s Controls Related to the Offsite Review List* (Report No. AUD-09-004). In the report, DSC pointed out that although the ORL may not have captured a significant percentage of institutions that were downgraded, the same institution may have been receiving additional supervisory attention through other monitoring tools.

Deposit Insurance Premiums

Although the LIDI downgrades indicated concern for the health of IMB, those rating changes did not require that the FDIC adjust the insurance premium rate paid by IMB or require the inclusion of IMB on the FDIC Problem Bank List (the FDIC's Problem Bank List only includes institutions with CAMELS composite ratings of 4 or 5). According to FDIC policy, effective on January 1, 2007, the insurance premium rate paid by an institution is dependent, in part, on the PFR's most recent CAMELS rating unless the FDIC disagrees with the rating. In 2007, OTS rated IMB a CAMELS composite 2 (with all components rated 2). The FDIC did not issue a problem bank memorandum until 2008; therefore, IMB's deposit insurance premium was unaffected. The FDIC ultimately lowered IMB's insurance premium rating to R-II (equivalent to a "1B" under the old system) during the first quarter of 2008 and lowered the rating again to R-IV (equivalent to a "3C" under the old system) in the second quarter of 2008. Table 15 shows the insurance premiums paid by IMB from 2001-2008, excluding payments related to the Financing Corporation.¹⁶

During a discussion of a draft version of this report, DIR officials confirmed that IMB's CAMELS rating and capital level determined IMB's risk category for deposit insurance premium purposes. During 2007, the FDIC assessed IMB at the highest rate possible under the R-I risk category. DIR officials noted that either the OTS would have had to lower IMB's CAMELS rating, or the FDIC would have had to have a ratings disagreement, or IMB would have had to be less than well-capitalized for the FDIC to increase IMB's insurance premiums despite the bank's higher-risk business activities and dependence on volatile funding sources. DIR noted that the risk-based assessment system's reliance on CAMELS and capital levels is based on regulation, not statute. In this regard, in 2006, DIR presented a briefing to the FDIC Board on insurance pricing and proposed to broaden the factors used in determining premium assessments for large banks in the R-I risk category. However, even under this proposal, a change in IMB's CAMELS or capital levels or a ratings disagreement would have been required to move IMB to a lower insurance premium risk category because IMB was already paying the highest rate under the R-1 risk category.

Table 15: IMB Insurance Assessment Payments 2001 to 2008

Year	FDIC Payment
2001	\$0
2002	\$920,080
2003	\$0
2004	\$0
2005	\$0
2006	\$0
2007	\$9,969,828
2008	\$4,653,702
Total	\$15,543,610

Source: FDIC's Division of Finance.

*Note: Between 1997 and 2006, institutions rated "1A" were generally not assessed a premium. A high percentage of institutions were classified as "1A".

¹⁶ The Financing Corporation has separate authority from the FDIC's authority to assess premiums for deposit insurance to collect funds from FDIC-insured institutions sufficient to pay interest on bonds related to the Federal Savings and Loan Insurance Corporation that were issued in the 1980s. The FDIC acts as a collection agent for the Financing Corporation.

Development of Capital Needs Model and New Reports

In addition to its routine analyses, at the direction of the FDIC Chairman, the FDIC also developed a capital needs model that analyzed the West Coast thrifts¹⁷ in order to determine the amount of capital required to keep those financial institutions as going concerns. This measurement of required capital was different from existing FDIC regulatory measurements, as it focused on forward-looking, long-term capital requirements similar to a private-sector purchase analysis rather than on more immediate requirements to meet regulatory capital thresholds.

In April 2008, the FDIC sent capital markets personnel to IMB to collect the required data to run the capital needs model to determine the amount of capital required to maintain IMB as a going concern. The model showed that IMB required between \$1 billion and \$3 billion. The FDIC shared its capital needs analysis with the OTS, but email correspondence indicated that the OTS disagreed with the model and its resulting analysis. However, the OTS did not have its own model to determine IMB capital requirements or refute the FDIC's model assumptions.

Additionally, the FDIC established regular meetings with the OTS, the PFR of the West Coast thrifts, and requested specific updates from OTS concerning IMB's liquidity position and access to funding from the FHLB and capital markets. Information from those reports was closely watched by FDIC regional and headquarters personnel.

Participation in OTS On-Site Examination

In September 2007, the SFRO Regional Risk Committee recommended exercising back-up examination authority for the West Coast Thrifts to include participation of FDIC capital markets experts in those examinations. After IMB announced its financial results for the third quarter of 2007 and reported a \$202 million loss (over five times higher than forecasted in a September 2007 press release), the FDIC made a formal request to OTS on November 16, 2007 for three FDIC examiners to participate with OTS in the January 2008 examination of IMB. The OTS Regional Director accepted the FDIC's request but suggested limited FDIC involvement as shown in the sidebar.

In January 2008, three FDIC examiners arrived at IMB to participate with the OTS in its examination. Of the three, only the Examiner-In-Charge remained for the duration of the examination. The FDIC drafted a problem bank memorandum based upon an OTS interim downgrade in the CAMELS composite rating from a

FDIC's November 2007 Back-up Examination Request

In the OTS Regional Director's December 10, 2007 letter to the FDIC accepting the backup examination authority request, the OTS regional director stated, "[a]s you know, Indymac Bank is currently composite "2" rated and does not fall within the normal protocol for FDIC participation; however, given significant changes in asset quality and earnings we suggest one FDIC examiner may wish to join the examination. Your request for three FDIC examiners is accepted; however, I hope that the FDIC team will scale back as work is completed."

¹⁷ The West Coast thrifts included institutions located on the West Coast that were identified by the FDIC as having residential real estate exposures similar to Countrywide.

2 to 3. The January 25, 2008 memorandum documented the OTS' significant downgrades in the component ratings for asset quality and earnings (2 to 4), and confirmed IMB's poor financial condition and operating results in the third and the fourth quarters of 2007.

The OTS and FDIC conducted a joint examination of IMB beginning on January 7, 2008, and the OTS issued its report of examination on June 20, 2008, 3 weeks before IMB's failure. However, before that report was issued, on May 27, 2008, the FDIC examiners prepared an Examination Findings Memorandum (Findings Memo) to document the FDIC's analysis of IMB. The FDIC's on-site examiner drafted the Findings Memo without receiving access to or copies of preliminary OTS memoranda or findings supporting the OTS examination. The Findings Memo noted IMB's record loss of \$565 million for 2007, increase in non-performing assets, and precarious liquidity situation. The Findings Memo preliminarily recommended a CAMELS composite rating of 4 and was not distributed to the OTS or IMB. The Findings Memo did not address enforcement actions.

The results of these supervisory efforts prompted the FDIC to issue two problem bank memoranda. On June 9, 2008, the FDIC issued a problem bank memorandum due to IMB's overall unsatisfactory condition. The CAMELS categories reflected unsatisfactory financial performance and operating results, but the critical issue facing the institution was liquidity stress. The memorandum noted that the bank's funding structure, dependent mainly on FHLB advances and high-cost brokered deposits, would be seriously affected if the institution fell below the well-capitalized category. The memorandum also noted IMB's deficient capital, poor asset quality, significant and continuing losses from operations, and ineffective rate sensitivity management. The memorandum indicated that the OTS had not completed its January 2008 examination.

On June 20, 2008, the OTS issued its examination results to IMB, and on June 25, 2008, the OTS notified the IMB Board of Directors of its CAMELS composite 5 rating. The OTS' report of examination said that IMB was at risk of failure if it was unable to increase capital to support its risk profile. The report noted the unprecedented decline in real estate values, increasing credit quality problems, and a collapse of the secondary market as factors contributing to IMB's capital erosion and undermining the viability of IMB's business model. The report included matters for IMB management's attention and corrective actions and, contemporaneous with the issuance of the report, the OTS entered into a memorandum of understanding, an informal enforcement action, that directed IMB's management and board to implement a capital restoration plan. On June 26, 2008, the FDIC issued an addendum to its June 9, 2008 problem bank memorandum, which downgraded IMB to a composite 5 rating.

Enforcement Actions

The FDIC did not request that the OTS take, or pursue its own, enforcement action against IMB. As discussed earlier, as the PFR, the OTS had primary responsibility for taking enforcement actions against IMB, and Treasury IG's material loss review faulted the OTS for not doing so. However, as discussed previously, 12 U.S.C. § 1818(t) allows the FDIC to take enforcement action against a non-FDIC-supervised institution when the PFR does not resolve the problems within 60 days or sooner if there are certain exigent circumstances. We did not see evidence that the FDIC encouraged the OTS to pursue enforcement actions against IMB or that the FDIC

considered imposing its own enforcement action against IMB under Section 8(t). We confirmed with the FDIC Legal Division that the FDIC has never made use of this provision to impose an enforcement action against a non-FDIC supervised institution.

In the case of IMB, DSC told us that pursuing such action would have been difficult given the OTS' consistent and favorable "2" composite rating of IMB. Specifically, DSC officials indicated that the following steps would be required to commence a Section 8(t) enforcement action.

- OTS would have to complete an examination of the bank.
- FDIC would have to issue its own examination findings supporting the need for an enforcement action.
- FDIC would need to hold discussions regarding the need for an enforcement action with OTS at the regional level.
- DSC and FDIC Legal would need to coordinate the pursuit of an enforcement action at the regional level and develop a written recommendation for the 8(t) action.
- The written recommendation and supporting case documentation would need to be processed by DSC's Risk Management and Application Section in the Washington Office, and DSC would need to coordinate the enforcement action with Legal at the Washington Office level.
- FDIC would need to hold discussions with OTS at the Washington Office level including discussions between the FDIC DSC Director and the OTS Senior Deputy Director.
- DSC and Legal would need to submit a decision case regarding pursuing an enforcement action to the FDIC Board.
- If the Board approved the case, OTS would have 60 days to resolve issues with the bank before the FDIC initiated the enforcement action.

Capital Reporting Irregularities

IMB filed its first quarter 2008 Thrift Financial Report (TFR) in April 2008 and reported that its regulatory capital exceeded the 10 percent regulatory threshold to be considered "well-capitalized." During a May 9, 2008 meeting, however, IMB's auditor Ernst & Young (E&Y) notified the OTS Regional Director and the IMB CEO that E&Y identified several differences it had with IMB's quarterly financial statements and that those differences combined with the effects of E&Y modifications from 2007 resulted in IMB's total regulatory capital falling below the required regulatory 10 percent threshold for a "well-capitalized" bank. In that event, statutory rules prohibited IMB from accepting brokered deposits to fund operations unless IMB received a waiver from the FDIC.¹⁸

During that same meeting, E&Y documents further state that the OTS Regional Director approved IMB's recording of a capital contribution from its parent corporation as part of IMB's regulatory capital for first quarter 2008 even though the contribution was not made until May 2008, well after the close of the first quarter. The capital contribution had the effect of raising IMB's regulatory capital above the required 10 percent threshold to maintain IMB's regulatory

¹⁸ According to Section 29 of the Federal Deposit Insurance Act, adequately capitalized institutions may accept brokered deposits if the FDIC grants a waiver. Undercapitalized institutions may not accept brokered deposits. See Appendix VII for a brokered deposit restriction chart.

“well-capitalized” status and avoid IMB requiring an FDIC waiver to continue accepting brokered deposits. Additionally, it was during this quarter that the OTS allowed IMB to pay a \$10 million dividend on its preferred shares. Documents show that the FDIC case manager was copied on this request. IMB subsequently filed an amended TFR after the May 9 meeting that continued to show that IMB’s regulatory capital exceeded the 10 percent threshold. Documents indicate the FDIC was not included in the conversations between OTS and E&Y, and the FDIC was unaware that the accounting for the May capital contribution averted brokered deposit limitations.¹⁹

Separate from this situation, emails indicate that the FDIC also had concerns with other items included in the computation of IMB’s first quarter of 2008 regulatory capital. Specifically, the FDIC Senior Large Financial Institution Analyst noted that intangible assets and deferred tax assets were not deducted by IMB in computing regulatory capital, and the risk weighting and rating of other assets was incorrect. Collectively, the capital accounting treatment, dividend payment, and potential adjustments noted by the FDIC would likely have dropped IMB’s regulatory capital below the “well-capitalized” threshold. In that event, statutory rules restrict an institution’s acceptance of brokered deposits and such restrictions had the potential to limit the cost to the Deposit Insurance Fund. Moreover, the value of assets pledged as collateral to secure FHLB advances would have been reduced, thereby limiting the amount of FHLB advances and possibly the cost of IMB’s failure. Further, it may have been possible for the FDIC to exercise its enforcement powers if it was determined that IMB was in an unsafe or unsound condition. In response to a draft version of this report, DSC reiterated the lengthy steps required to pursue an 8(t) enforcement action and stated that it would not have been feasible pursue an enforcement action before IndyMac failed in July 2008.

Receipt of Deposit Downloads in Preparation for Resolution

Based on the financial conditions observed at the bank, DSC began coordination efforts with the FDIC’s DRR in March 2008. The FDIC received the first deposit download from IMB to begin analysis of IMB accounts for a potential FDIC insurance payout. Following the FDIC’s capital modeling results, which indicated that IMB would require \$1 to \$3 billion in capital to remain viable, DRR obtained a second deposit download on April 23, 2008. Further, the FDIC examiner relayed information to the FDIC regional office and headquarters about increasing liquidity constraints due to the FHLB’s reduction of IMB’s borrowing capacity and tightening of collateral requirements. At that time, IMB’s capital levels were on the brink of falling below the regulatory well-capitalized threshold.

IMB suffered a withdrawal of \$1.55 billion by its depositors after a letter published on June 26, 2008 to IMB’s regulators from a New York Senator raised concern about IMB’s viability. On July 1, 2008 the OTS issued a supervisory directive and troubled condition letter to IMB. Also on July 1, 2008, OTS informed IMB that it would no longer be able to accept brokered deposits. Until that point in time, the bank had continued to place orders with brokers for additional deposits. On July 11, 2008, the OTS closed IMB and the FDIC was named conservator.

¹⁹ Interviews of FDIC regional personnel also indicate the FDIC was unaware of the meeting.

CONCLUSIONS AND MATTERS FOR FURTHER CONSIDERATION

The FDIC identified and monitored the risks that IMB presented to the Deposit Insurance Fund primarily through two means: (1) broad risk monitoring activities conducted by DIR and FDIC risk committees and (2) analysis of IMB-specific data. Additionally, the FDIC participated in a back-up examination capacity in on-site IMB examinations with the OTS in 2001, 2002, and 2003. All of these activities identified risks associated with IMB's operations. Nevertheless, until late in 2007, FDIC officials consistently concluded that despite its high-risk profile, IMB posed an ordinary or slightly more than ordinary level of risk to the insurance fund based on IMB's CAMELS ratings. By the time the FDIC increased its monitoring of IMB, resumed its on-site presence, and assessed a higher insurance premium, IMB's financial condition was irreparable due to the decline in real estate values, increasing credit quality problems, and the collapse of the secondary market. Further, notwithstanding IMB's generally unsatisfactory financial performance starting in 2007, the FDIC did not request that the OTS take or pursue its own enforcement action against IMB, citing OTS' consistently favorable composite ratings and the protracted process for taking such action as substantial obstacles.

This evaluation focused on the FDIC's role in monitoring one institution—IMB. Therefore, we are not in a position to reach conclusions or make recommendations on the design and implementation of the FDIC's system for monitoring risk or making deposit insurance assessments. Further, we recognize that the FDIC has taken and is considering actions to address lessons learned to date as a result recent events in the banking industry. With that in mind, we offer the following as matters for further study and consideration by management.

The FDIC's Frameworks for Establishing A Supervisory Approach and Making Deposit Insurance Determinations

The FDIC could give greater consideration to its own independent determination of risk as insurer (e.g., through LIDI reports and offsite monitoring efforts) in establishing its supervisory approach and assessing premiums for non-supervised institutions, rather than relying too heavily on CAMELS ratings from the PFR that may not consider the risks that an institution presents to the insurance fund. Although the FDIC has made some changes to the insurance assessment process, the assessments are still principally driven by the CAMELS composite rating and capital levels. Revising the existing supervisory approach and deposit insurance frameworks to provide the FDIC with more independence and flexibility could increase the utility of the significant resources that the FDIC invests in its internal monitoring systems, reports, and analyses.

Delegations of Authority and Reporting Requirements Surrounding Back-up Examination Authority Decisions

As discussed in the report, case managers prepare a memorandum documenting the basis for a back-up examination request and submit the request to the FDIC Regional Director or Deputy Regional Director who may accept or reject the request. The FDIC regional offices report back-up examination requests that have been completed or that are in process to the FDIC DSC Director in Washington. The report does not, however, track recommendations for back-up

examinations that are not approved by FDIC regional management. Given the significance of back-up examinations to the FDIC's supervisory approach, regional decisions to not approve back-up examinations may warrant higher-level management attention in Washington, or at a minimum, should be reported to DSC Washington officials for risk monitoring or interagency coordination purposes.

Appointment and Transition of Case Managers for Large, High-Risk Institutions

Case managers play a critical role in assessing the risk an institution poses to the Deposit Insurance Fund. Achieving continuity of case managers is important because the case manager builds a relationship with the institution and the PFR, and develops a comprehensive understanding of each company's operations, risks, and business lines. Three different case managers were assigned to monitor IMB during one 18-month period because of a number of reorganizations and other staffing changes. Although the SFRO worked to ensure that transitions between case managers were smooth, additional guidance may be helpful to more efficiently and effectively transition oversight between existing and new case managers.

Authorities Related to Requesting Back-up Examinations and Pursuing Enforcement Actions Against Non-Supervised Institutions

While the OTS generally allowed the FDIC to participate in on-site examinations, had the OTS disagreed with FDIC back-up examination requests, or limited the FDIC's presence as occurred at the January 2008 examination, FDIC regional officials may have been reluctant to pursue obtaining the authority given the resources required to challenge and overturn the PFR's decision. In the event that the FDIC and the PFR disagree as to the condition of an institution for purposes of exercising back-up authority, resolving the matter can require involvement on the part of the FFIEC as well as the FDIC Chairman and the head of the cognizant regulatory agency.

With respect to the FDIC pursuing enforcement actions against non-supervised institutions, IMB's improper treatment of a capital contribution, together with other computations of concern to the FDIC in the first quarter of 2008, would likely have dropped IMB's regulatory capital below the "well-capitalized" threshold. As a result, it may have been possible for the FDIC to exercise its enforcement powers if it was determined that IMB was in an unsafe or unsound condition. FDIC management officials told us, however, that pursuing such action would have been difficult, if not impractical, in light of IMB's historically favorable composite ratings and the time and resources that would need to be committed to complete the required steps.

Both of these authorities are important tools that can be used by the FDIC to protect the insurance fund. However, the Corporation's ability to use the tools could likely be enhanced by more efficient and streamlined processes.

CORPORATION COMMENTS AND OIG EVALUATION

On August 17, 2009, the Director, DSC, provided a written response to the draft of this report. DSC's response is presented in its entirety in Appendix IX. DSC's response addressed two of our four matters for further consideration. DSC indicated that steps were underway to track all recommendations for back-up examinations and that higher-level management review of such information may be warranted. DSC also discussed that it has made improvements in LIDI reporting and instituted a quality assurance process for LIDI reporting that should help to address case manager appointment and transition.

DSC's response did not specifically address our matters for further consideration related to (1) the FDIC's frameworks for establishing a supervisory approach and making deposit insurance determinations or (2) authorities related to requesting back-up examinations and pursuing enforcement actions against non-supervised institutions. Because the draft report contained no recommendations, a written response to each of the matters for further consideration was not required. These matters involve important regulatory and interagency policies, procedures, and practices that may be more appropriately considered at the FDIC Board of Directors level.

Objective, Scope, and Methodology

The objective of our review was to evaluate the FDIC's role in monitoring IMB, including determining: (1) when the FDIC became aware of problems at IMB and (2) what actions were taken by the FDIC to mitigate those problems. The scope of our review included evaluating documents and actions taken by FDIC from the inception of IMB in July 2000 to July 2008 when IMB was placed into conservatorship.

Specifically, we:

- Reviewed the *Case Managers Procedures Manual* to identify the required actions to be taken by case managers, such as preparing offsite monitoring reports, Summary Analysis of Examination Reports, Large Insured Depository Institution (LIDI) reports, and the Risk-Related Premium System Reconciliation List;
- Reviewed and developed process maps for required monitoring activities according to the *FDIC's Case Managers Procedures Manual*;
- Obtained and reviewed all required case manager reports mentioned above to determine whether they were prepared;
- Interviewed five FDIC San Francisco Region case managers who had overall responsibility for IMB at varying points during FDIC's supervisory period;
- Interviewed San Francisco Region management officials for their views on the FDIC's supervisory oversight of IMB;
- Interviewed FDIC regional capital markets specialists;
- Reviewed the interagency agreement entitled "*Coordination of Expanded Supervisory Information Sharing and Special Examination*" to determine when the FDIC can invoke the back-up examination authority;
- Interviewed DSC Headquarters management officials for their views on the supervisory oversight of IMB and requests for back-up authority;
- Interviewed the FDIC Examiner-in-Charge who participated in OTS' examination of IMB in January 2008;
- Reviewed documents in the case manager files in the FDIC's San Francisco Regional Office;
- Generated a timeline of all FDIC activities and significant events during the IMB supervisory period;
- Reviewed OTS work papers for information relevant to issues noted at IMB and correspondence with the FDIC; and
- Reviewed Ernst & Young (IMB's external auditors) work papers for relevant issues with respect to IMB capital contributions.

We performed our evaluation from October 2008 through April 2009 in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

Glossary of Terms

Alt-A Loan	A mortgage made to a borrower that typically does not involve verification or documentation of income, assets, or employment. Instead, the approval of the loan is based primarily on the applicant's Fair Isaac Corporation (FICO) credit score.
Brokered Deposits	Deposit brokers provide intermediary services for banks and investors by linking bankers to a broad range of potential investors who have no relationship with the bank but who actively seek the highest returns offered within the financial industry.
CAMELS	CAMELS is the acronym for the six essential components used to rate an institution's financial condition under the Uniform Financial Institution Rating System. CAMELS components include: <u>C</u> apital adequacy, <u>A</u> sset quality, <u>M</u> anagement, <u>E</u> arnings, <u>L</u> iquidity, and <u>S</u> ensitivity to market risk. CAMELS ratings include a numeric score for each of the six components and an overall numeric composite rating. The numeric ratings range from 1 (best) to 5 (worst) and generally mean: <ul style="list-style-type: none"> 1 - Sound in every respect 2 - Fundamentally sound 3 - Some degree of supervisory concern 4 - Unsafe and unsound practices or conditions 5 - Extremely unsafe and unsound practices or conditions
Federal Home Loan Bank (FHLB)	The Federal Home Loan Bank (FHLB) System is composed of 12 Federal Home Loan Banks that provide its member institutions with financial products and services to assist and enhance the members' financing of housing and community lending. Each FHLB is a separate legal entity that is cooperatively owned by its member financial institutions within distinct geographic areas that the FHLB has been designed to serve. The FHLB System is considered a government sponsored entity since it was expressly created by Congress in 1932 and its obligations are considered to be implicitly guaranteed by the federal government.
LIDI	Large Insured Depository Institution
Mortgage Servicing Rights	Mortgage servicing rights are contractual obligations undertaken by an institution to service a mortgage. Common rights include: the right to collect mortgage payments monthly, set

aside taxes and insurance premiums in escrow, and forward interest and principal to the mortgage lender.

Prompt Corrective Action (PCA)

Section 38 of the Federal Deposit Insurance Act requires that federal regulators initiate actions when an institution fails to meet minimum capital thresholds. See Appendix VII for PCA capital categories.

Securitization

The process of purchasing and pooling mortgage loans and issuing securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool.

Tier 1 (Core) Capital

Is a regulatory measure of an institution's financial strength and generally includes equity capital (common stock, non-cumulative perpetual preferred stock and minority interests in consolidated subsidiaries).

Case Manager Responsibilities

Directing Supervisory Strategy	– The supervisory strategy of all FDIC insured institutions is primarily driven by statute according to their CAMELS rating, with adjustments resulting from changes in an organization’s risk profile, structure, business strategies, or logistical considerations.
Establishing and Maintaining a Dialogue with the Primary Regulator	– The goal of this dialogue will be to enhance proactive risk assessment in a non-intrusive manner. Therefore case managers must remain cognizant that inquiries should address information important to this risk assessment objective.
Reviewing Examination Reports, Applications, Investigations and Correspondence	– These activities include, among other things, preparing summaries of findings, memoranda, correspondence, and recommendations for the DSC Regional Director, Washington Office, State Authorities, other Federal regulatory agencies, and financial institutions.
Initiating and Developing Corrective Programs	– This often involves initiating, coordinating, or participating in conferences and meetings with DIR and other supervisory authorities and bank officials, and developing informal and formal programs designed to correct deficiencies in the operations and condition of the financial institution.
Coordinating with Specialty Areas	– Communication and coordination with Regional specialists on substantive issues regarding institutions within the case manager’s caseload to ensure that a proper supervisory action is taken to minimize risk to the Deposit Insurance Fund. For IMB, the Capital Markets specialist played a critical role.
Preparing Management Information Reports	– Case managers prepare or provide critical input to a variety of reports to ensure that senior management within the FDIC (regional, divisional, and corporate-wide) is informed of significant existing or emerging risks on specific institutions within their respective caseloads.
Performing Offsite Monitoring and Preparing Analyses	– The FDIC’s offsite monitoring programs are used to identify an institution or group of institutions that pose elevated risks to the insurance fund so that supervisory strategies can be adjusted. The offsite reviews are intended to identify potential emerging problems and, as such, include only 1-and 2-rated institutions.
Keeping Abreast of Current Economic Trends	– Case managers need to maintain an awareness and understanding of economic and financial trends that could impact the condition of institutions within their assigned caseload.

Source: *Case Managers Procedures Manual*.

Timeline of Significant Events

Date	Event
07/01/2000	– IMB formed when the First Federal Savings and Loan association of San Gabriel Valley becomes a wholly-owned subsidiary of Indymac Bancorp. Inc. The thrift changed its name to IMB Bank FSB, became an OTS-chartered institution and an insured institution.
04/16/2001	– OTS and FDIC begin first examination of IMB.
08/24/2001	– OTS agrees with FDIC composite CAMELS rating and downgrades IMB from a 2 to 3.
09/21/2001	– The FDIC drafts an internal problem bank memorandum for IMB.
11/05/2001	– The FDIC and OTS make a joint visit to IMB to review areas that had not been covered during the initial examination.
04/05/2002	– The FDIC issues another internal problem bank memorandum noting continued problems at IMB. The memorandum states that OTS does not have any formal or informal corrective programs in place for IMB but has requested that IMB temper growth and submit a revised strategic plan in 2 years.
07/29/2002	– The FDIC and OTS conduct a joint examination of IMB. The FDIC notes that it is in agreement with the OTS on IMB's composite CAMELS rating but disagrees with OTS on the management and asset quality ratings.
09/29/2003	– The FDIC and OTS conduct a joint examination of IMB.
06/18/2004	– FDIC SFRO Regional Director determines exercising back-up examination authority for the 2004 examination of IMB is not warranted.
11/15/2004	– The OTS begins the 2004 IMB safety and soundness examination.
11/07/2005	– The OTS begins the 2005 IMB safety and soundness examination.
01/08/2007	– The OTS begins its 2006 IMB safety and soundness examination.
08/09/2007	– Countrywide suffers a liquidity crisis and the FDIC worries that Countrywide may fail. The FDIC identifies institutions with business profiles similar to Countrywide that may also suffer similar liquidity issues. IMB and other West Coast thrifts are on that list.
08/22/2007	– IMB changes its business strategy to become an originator of conforming loans and a reverse mortgage lender.
09/12/2007	– The FDIC SFRO Risk Committee recommends that the FDIC invoke back-up examination authority for IMB and other West Coast thrifts.
11/16/2007	– The FDIC requests participation in the OTS examination to commence in January 2008.
4 th Qtr. 2007	– IMB moves \$10.7 billion of loans from the held for sale account in its balance sheet to held for investment because of the problems in secondary market.
11/16/2007	– The OTS approves IMB's request to pay \$10 million dividend on perpetual non-cumulative preferred shares on December 31, 2007.
12/10/2007	– The OTS accepts the FDIC's request for back-up examination authority but wants no more than three FDIC examiners to participate.
01/07/2008	– The OTS begins its examination of IMB 4 months before the scheduled date. Three FDIC examiners participate with the OTS.
01/17/2008	– The OTS downgrades IMB from a CAMELS composite 2 to a 3.

Appendix IV

Date	Event
01/25/2008	– The FDIC issues an internal problem bank memorandum documenting the OTS’ significant downgrades in the component ratings for asset quality and earnings (2 to 4), confirming IMB’s poor financial condition and operating results in the third and fourth quarters of 2007, and noting that preliminary capital ratios as of the fourth quarter 2007 were below agreed-upon levels.
03/07/2008	– The FDIC receives the first download from IMB to determine insured deposits.
03/17/2008	– IMB pays \$10.6 million dividend on perpetual non-cumulative preferred shares. The OTS approved the request for the dividend on February 12, 2008.
05/07/2008	– The FDIC presents its capital needs model results to OTS showing that IMB needs between \$1 billion and \$3 billion to remain a going concern.
05/09/2008	– Conference call with IMB CEO, OTS Regional Director, and Ernst & Young personnel where the OTS agrees that a capital contribution from IMB’s parent company that was actually made in May 2008 could be considered made prior to March 31, 2008 in order to raise regulatory capital above the well-capitalized threshold.
05/27/2008	– The FDIC issues its finding memorandum under its back-up examination authority. The preliminary recommendation is a CAMELS composite 4 rating. The FHLB also increases collateral requirements for IMB portfolios.
06/9/2008	– The FDIC issues an internal problem bank memorandum.
06/11/2008	– OTS presents IMB with a Memorandum of Understanding that the IMB Board of Directors signs on June 26, 2008.
06/20/2008	– The OTS issues its report of examination, downgrading IMB to a CAMELS composite 5.
06/26/2008	– The FDIC amends its June 9, 2008 problem bank memorandum and rates IMB a CAMELS composite 5. This same day a New York Senator’s letter to IMB’s regulators about IMB’s viability is published and IMB suffers a withdrawal of \$1.3 billion by its depositors.
06/25/2008	– The OTS and the FDIC meet with IMB management and some Board members to inform them of the CAMELS composite 5 rating.
07/01/2008	– OTS issues a supervisory directive and troubled bank letter to IMB.
07/10/2008	– OTS’ Senior Deputy Director signs the decision memorandum to close IMB.
07/11/2008	– OTS closes IMB and the FDIC is named conservator.
07/14/2008	– IndyMac Federal Bank, FSB opens for business.

FDIC Offsite Monitoring Systems and Reports

Monitoring Tool	Frequency	Definition
SCOR – Statistical CAMELS Offsite Rating	Quarterly	A financial model that uses statistical techniques, offsite data, and historical examination results to assign an offsite CAMELS rating and to measure the likelihood that an institution will receive a CAMELS downgrade at the next examination.
SCOR-Lag	Quarterly	A derivation of SCOR that attempts to more accurately assess financial condition in rapidly growing banks. SCOR-lag begins with current period SCOR data and then adjusts the asset quality ratios by a one-year lag. For example, the numerator for lagged past due ratios is the current period past due while the denominator uses loans from one year earlier.
REST – Real Estate Stress Test	Quarterly	Attempts to simulate what would happen to banks today if they encountered a real estate crisis similar to that of New England in the early 1990s. REST uses statistical techniques and Call Report data to forecast an institution’s condition over a 3 to 5 year horizon and provides a single rating from 1 to 5 in descending order of performance quality.
GMS – Growth Monitoring System	Quarterly	Identifies institutions experiencing rapid growth and/or having a funding structure highly dependent on non-core funding sources. Using statistical techniques, GMS analyzes financial ratios and changes in volume to identify banks that have experienced rapid growth and assigns a percentile ranking between 0 and 99.
CG – Consistent Grower	Quarterly	A cumulative growth score for an institution using up to 20 quarters of GMS scores. Individual quarter GMS scores are weighted based on the percentile rank for each period. This weighting process results in a single GMS score that is representative of multiple periods.

Appendix V

Monitoring Tool	Frequency	Definition
QLA – Quarterly Lending Alert	Quarterly	Developed to identify institutions exhibiting high-risk lending activity such as subprime lending.
Young Institutions	Ongoing	A flag that identifies institutions that are less than 8 years old. Research indicates that, on average, newly chartered institutions take approximately 8 years to perform similar to established institutions.
Multiflag	Quarterly	Combines the multiple risk measures discussed above. The thresholds are relaxed to allow for the convergence of multiple risk exposures. This allows institutions that would not normally be identified by a single measure to be identified as a multiflag outlier. Institutions with multiple exceptions are considered high risk. In order to be identified as a multiflag, an institution must exceed four or more of the following thresholds: SCOR or SCOR-lag greater than 2.10; REST rating of 3.50 or greater; GMS rating in the 90 th percentile or greater; Consistent Grower rating of 90 or greater; QLA flag of “Y”; and a Young Institution flag of “Y.”
ORL – Offsite Review List	Quarterly	CAMELS composite 1- and 2-rated institutions are included on the ORL based on the SCOR, SCOR-Lag, and GMS risk measures. The ORL includes those 1- and 2-rated institutions identified by SCOR or SCOR-Lag as having a 35 percent or higher probability of downgrade to 3 or worse. Institutions with a composite rating of 1 or 2 and in the 98 th or 99 th GMS growth percentile are also included on the ORL.
Risk Related Premium System (RRPS) Reconciliation List	Semiannual (prior to 1/1/07) Quarterly (after 1/1/07)	The two components of the RRPS, the supervisory subgroup and capital group, determine the assessment risk classification rate of an institution and ultimately an institution’s insurance premium. The supervisory subgroup is based on an institution’s CAMELS rating. Each quarter RRPS compares CAMELS ratings provided by the other federal regulators to those stored in the FDIC’s ViSION database and identifies institutions whose ratings differ. Those institutions are placed onto a reconciliation list. A case manager must review each institution on the list and determine whether the CAMELS rating in ViSION, the CAMELS rating provided by the other regulator, or a different CAMELS rating discovered during the review should be used. RRPS then assigns the Supervisory Group based on the CAMELS ratings verified by the case manager.

Appendix V

Monitoring Tool	Frequency	Definition
Uniform Bank Performance Report (UBPR)	Quarterly	The UBPR is an analytical tool created for bank supervisory, examination, and management purposes. The report is computer generated from a data base derived from public sources. It contains several years' worth of data in the form of ratios, percentages, and dollar amounts computed mainly from Reports of Condition and Income submitted by the bank. Each UBPR also contains corresponding average data for the bank's peer group and percentile rankings for most ratios. The UBPR therefore permits evaluation of a bank's current condition, trends in its financial performance, and comparisons with the performance of its peer group.
Uniform Thrift Performance Report (UTPR)	Quarterly	OTS' national financial monitoring report used by OTS examiners and analysts to monitor and analyze the activities, condition, and performance of individual thrift institutions. The UTPR is also used to focus examiner efforts for on-site examinations of thrifts. First developed in 1992, the detailed UTPR tracks a savings association's financial information over a 3-year period. OTS computers produce a UTPR for each savings institution, using data submitted by savings associations in their quarterly Thrift Financial Reports. A UTPR report compares a thrift institution to other peer group associations using percentile ranks and medians, and identifies trends.
Supervisory Watch List	Ad Hoc	A list in each region that identifies the region's selection of institutions for close monitoring. The list is more expansive than the FDIC Problem Bank List.
Annual Report Review	Annual	Insured depository institutions with total assets of \$500 million must engage a public accountant to prepare annual financial statements in accordance with Generally Accepted Accounting Principles (GAAP), and produce annual reports. The case manager is responsible for making a determination as to whether a change in supervisory strategy or follow-up action is needed.
Summary Analysis of Examination Report (SAER)	Based on Examination Schedule	The SAER provides a historical record of an institution, and includes comments briefly summarizing examination findings. In developing SAER comments, emphasis is placed on the CAMELS components and weaknesses identified in the report of examination.

Large Insured Depository Institution (LIDI) Ratings

Rating	Definition
A	Low level of concern regarding ultimate risk to the insurance funds: Organizational structure, financial condition, and operating performance exhibit stability and are strong (or are expected to become strong in the near-term (not to exceed 1 year)) based upon well-defined established trends or other available and reliable information. Management team is well regarded. Reasonably expected changes in operating environment are not likely to materially raise the company's risk to the FDIC insurance funds. The likelihood of regulatory intervention is remote.
B	Ordinary level of concern regarding ultimate risk to the insurance funds: Organizational structure, financial condition, and operating performance are good (or are expected to become good in the near-term) even though the company may exhibit some modest weakness in one or more fundamental areas of evaluation. Overall trends are stable, but some downward movement may be evident. Management is considered capable. The company may be more vulnerable to operating environment changes than those rated A, but still should be able to adapt without materially raising the company's risk to the FDIC insurance funds. Barring unusual circumstances, regulatory intervention is unlikely.
C	More than an ordinary level of concern regarding ultimate risk to the insurance funds: Organizational structure, financial condition, or operating performance are marginal (or are expected to be marginal in the near-term). Erratic trends also may be evident. At least one significant weakness had been noted in a critical area. Management's abilities may be considered marginal relative to the operational needs of the company. Reasonably expected operating environment changes could materially raise the company's risk to the FDIC insurance funds. Despite evident weakness, probability of failure or need of FDIC financial assistance in the short- to immediate-term is unlikely.
D	High level of concern regarding the ultimate risk to the insurance funds: Organizational structure, financial condition, or operating performance lack stability and exhibit (or are expected to exhibit in the near-term) pronounced weakness in several fundamental areas of evaluation. Overall evaluation is poor. Management resources may be inadequate. The company may also be unduly vulnerable to reasonably expected changes in the institution's operating environment. There is a distinct possibility of failure or need of FDIC financial assistance if problems identified are not addressed in the short- to immediate-term.
E	Serious concerns regarding ultimate risk to the insurance funds: Organizational structure, financial condition, or operating performance exhibited (or are expected to exhibit in the near-term) indicate the company may not be viable. At least one significant insured subsidiary at risk of failure. Disbursement of deposit insurance funds in less than 24 months is probable.

Source: *Case Managers Procedures Manual*, Chapter 11

PCA Capital Categories and Brokered Deposit Restrictions

Category	Total Risk-Based Capital	Tier 1 Risk-Based Capital	Leverage Ratio	Brokered Deposit Restrictions ¹
Well Capitalized	10 percent or more	6 percent or more	5 percent or greater	None
Adequately Capitalized	8 percent or more	4 percent or more	4 percent or greater or 3 percent or greater if bank has a composite CAMELS rating of "1"	The institution must request a waiver from the FDIC to accept brokered deposits.
Undercapitalized	Less than 8 percent	Less than 4 percent	Less than 4 percent or less than 3 percent if bank has a composite CAMELS rating of "1"	The institution cannot receive brokered deposits.
Significantly Undercapitalized	Less than 6 percent	Less than 3 percent	Less than 3 percent	The institution cannot receive brokered deposits.
Critically Undercapitalized	The institution's tangible equity is 2 percent or less regardless of its other capital ratios			The institution cannot receive brokered deposits.

Source: Section 38 of the FDI Act.

Note: (1) Section 38(e) of the FDI Act imposes several other mandatory restrictions or actions for institutions that fall below adequately capitalized.

Financial and Supervisory Data for IMB – 2001-2008

	Phase I			Phase II				Phase III				
	2001	2002	2003	2004	2005	2006	1 Qtr. 2007	2 Qtr. 2007	3 Qtr. 2007	4 Qtr. 2007	1 Qtr. 2008	2 Qtr. 2008
IMB Financials and CAMELS/Insurance Ratings												
IMB Assets (\$ Billions)	7.4	9.5	13.1	15.6	20.3	28.7	29.1	31.3	33.5	32.5	32	30.7
IMB Net Income/(Loss) (\$ Millions)	119	143	180	183	307	357	59.4	50	(183)	(491)	(168)	n/a
CAMELS Composite Rating	3	2	2	2	2	2	2	2	2	2	3	5
FDIC Insurance Premium Rating	1A	1A	1A	1A	1A	1A	1A	1A	1A	1A	1B	3C
FDIC Risk Monitoring												
SAER Completed^a	✓	✓	✓	✓	✓	n/a	✓	n/a	n/a	n/a	n/a	✓
LIDI Report Completed with Rating^b	No	✓	B/C	B/C	B/C	B/C	B/C	Inc	C	D	E	n/a
ORL Triggered			3Q 4Q	1Q 2Q 3Q	2Q 3Q	3Q 4Q					n/a	n/a
Reconciliation List Triggered	7/01		1/01 7/01	1/01 7/01	1/01 7/01	1/01						n/a
Completion of required reports	No	✓	✓	✓	✓	✓	✓	No	✓	✓	✓	✓
FDIC Problem Bank Memo	9/21	4/05									1/25	6/09
Regulatory Tools Used by FDIC												
Back-up Examination Requested	✓	✓	✓	✓ Denied by SFRO						✓		
Enforcement Actions												

Notes:

^aThe examination report for financial information as of September 30, 2006 was not completed until 1st quarter of 2007.

^bThe 1st quarter of 2001 LIDI report was missing, but the FDIC was with the OTS examining IMB at that time. The 2nd quarter 2007 LIDI was incomplete because financial data was included in the report, but the case manager narrative was missing. That report was the first under a new LIDI reporting system.

Corporation Comments



Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Supervision and Consumer Protection

August 17, 2009

MEMORANDUM TO: Stephen M. Beard
Assistant Inspector General for Evaluations and Management

FROM: Sandra L. Thompson
Director

SUBJECT: Response to the Draft Audit Report Entitled, *The FDIC's Role in the Monitoring of IndyMac Bank (Assignment No. 2008-043)*

We have reviewed the Office of Inspector General's (OIG) draft evaluation report, dated June 26, 2009, entitled *The FDIC's Role in the Monitoring of IndyMac Bank (IMB)*. The Office of Thrift Supervision was the primary federal regulator (PFR) for IMB from 2000 to 2008. The report outlines the FDIC supervisory role and authorities as the back-up supervisor, and summarizes the sequence of events leading up to IMB's failure, including FDIC's involvement and analysis both on- and off-site. Although the OIG makes no recommendations, we offer our response to some of the matters for further consideration identified in the report.

We agree that DSC should track all recommendations for back-up examinations. Specific steps are now underway to develop such a process, including the possibility of including this information in the quarterly LIDI report. We agree that this type of information may warrant a higher-level management review and would be useful for risk monitoring purposes and interagency coordination.

With respect to the appointment and transition of case managers for large, high risk institutions, DSC implemented in 2007 a revised Large Insured Depository Institution (LIDI) reporting process that synthesizes information from both internal and market-based sources to improve off-sight monitoring of large banks. Additionally, we implemented both a qualitative and quantitative Quality Assurance (QA) process for the LIDI report in 2007 and in mid-2009 respectively. Both the improved LIDI report and QA processes are designed to address some of the concerns expressed in the draft evaluation report about case manager appointment and transition.

Thank you for the opportunity to respond to your report. The FDIC continues to look for and implement improvements to our supervisory program in an effort to address lessons learned from the failure of institutions, such as IMB, as well as recent events that have impacted the banking industry.